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China consumer report 2021

Understanding Chinese Consumers: Growth Engine of the World

Special edition

November 2020

China consumer report 2021

Understanding Chinese Consumers: Growth Engine of the World

Special edition

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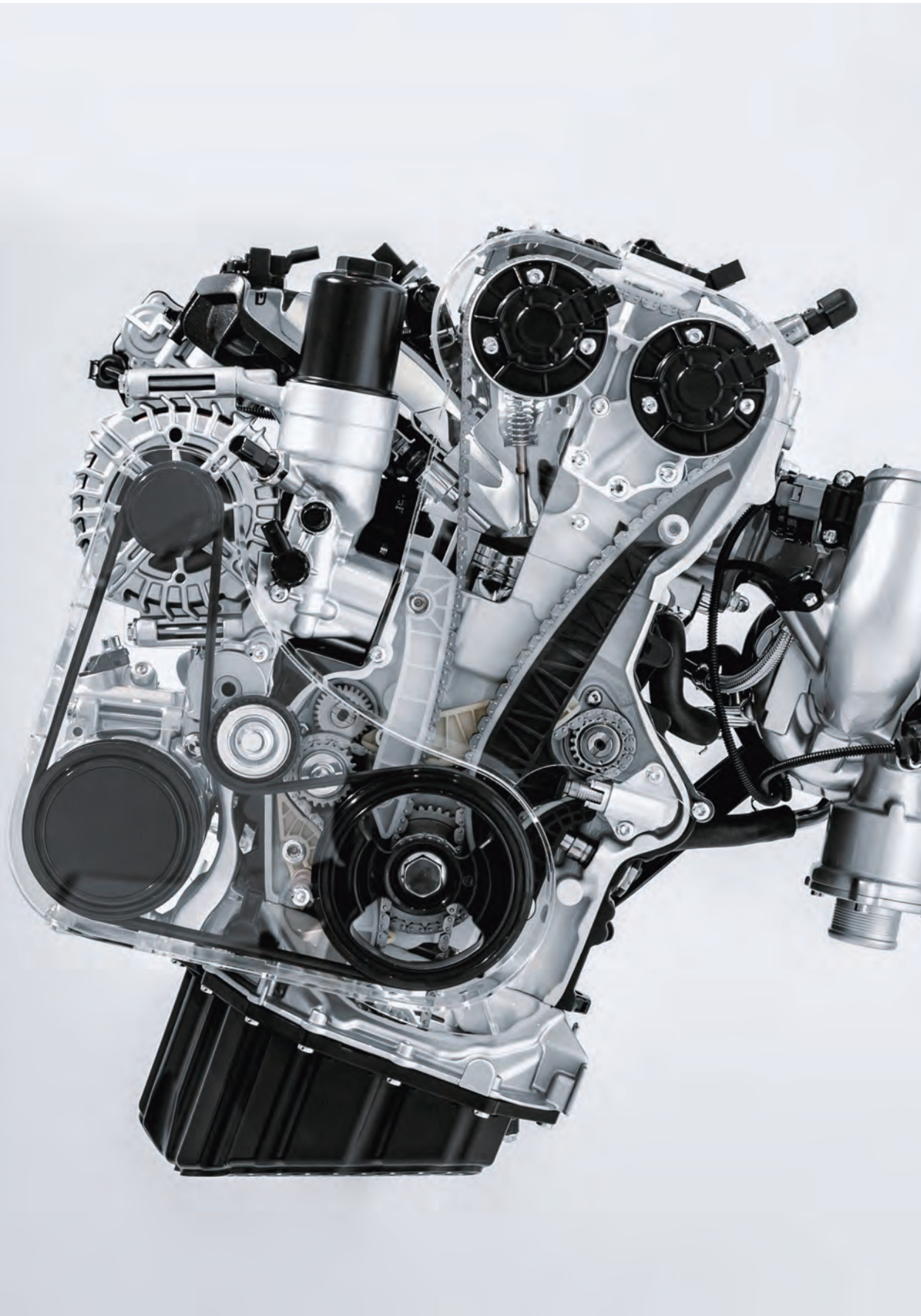


Foreword

China: Still the world's growth engine after COVID-19

In early January, our main concern was choosing where to go with our families to celebrate the Lunar New Year. Then, just a few days before the holiday began, the announcement of a lockdown in Wuhan threw all our plans into disarray. The outbreak of the COVID-19 pandemic changed life as we knew it literally overnight. Measures to contain the spread of the novel coronavirus drastically altered the way consumers behaved and how companies ran their operations. Everyone from frontline staff to executives were impacted by a temporary ban on travel, the move to remote working, and the impossibility of entertainment or excursions outside home. Even though China's recovery is now gaining momentum, all of us are grappling with a new environment in which digital tools and innovation have proved indispensable.

At McKinsey, we redoubled our efforts to help clients and colleagues in China to maneuver through the crisis. We also worked hard to share crucial lessons with other parts of the world, connecting the dots on best practice on reopening businesses while keeping workers and consumers safe. Meanwhile, we conducted extensive research over the course of the past few months to help China-focused consumer and retail companies to emerge from the pandemic in a position of strength. Drawing on proprietary insights, we investigated how consumer behavior shifted and will continue to shift during and post-COVID-19, how consumer and retail companies are responding, and how China is faring versus other markets. We collaborated with Oxford Economics to project macro-economic recovery curves; conducted monthly polls of executive opinion on likely recovery scenarios; tapped into research by the McKinsey Global Institute (MGI) on long-term trends; took our weekly "pulse" surveys, which were conducted multiple times to assess consumer sentiment in China and 44 other countries worldwide; and executed an in-depth analysis of over 100 million points-of-sale data on purchase behavior before, during, and after the COVID-19 crisis.

This special edition of the China Consumer Report provides perspectives on the trends that are defining the 'next normal' in post-pandemic China. The articles within aim to provide consumer and retail companies with the insights necessary to thrive in this challenging environment. In keeping with the competitive spirit of the consumer sector, we selected racing as our theme. We begin with 'Revving the engine', a section that brings together our latest consumer insights, starting with an MGI report that puts China's experience in a global context, showing how the pandemic has accelerated several pre-existent trends, notably digitization and the increasing prudence and health consciousness of Chinese consumers. The remarkable resilience of those consumers continues to impress, with our second article revealing that they remain among the most optimistic in the world, and expect a more rapid return to normal versus their counterparts in other markets. This sense of confidence helped China's retail sales return to growth in August, indicating the potential for Chinese consumers to drive not just a domestic economic recovery, but potentially a global one as well.

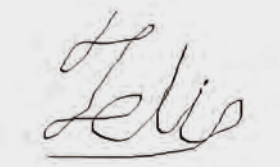
COVID-19 has changed the ways consumers behave across multiple aspects—from shopping for groceries to traveling to purchasing luxury goods, and we further deep-dive into how the pandemic has shaped these industries. For example, 'Winning the future of grocery retail in China' forecasts robust growth for the China market but cautions that key players must make significant strategic shifts in order to keep pace with the breakneck speed of digital innovation. We then look at what the world can learn from the reopening of China's tourism industry, and finally, we round out this section by drilling down into how the pandemic has changed the outlook for luxury goods companies.

In 'The driver's seat', we interview the leaders of the China operations at two of the world's most iconic consumer companies—Coca-Cola and McDonald's. Phyllis Cheung, Chief Executive Officer of McDonald's China, and Curt Ferguson, President of Coca-Cola Greater China and Korea, share their experiences in leading their companies during the crisis, and provide insights on what lies ahead for consumer and retail companies in China.

During the pandemic, consumers doubled down on digitization, a subject we address in the next section, 'Tuning up for maximum performance'. We provide guidance on how the right business-to-business strategies can capture growth from digitization, and explain how direct-to-consumer social commerce models can grow online traffic and acquire new users at optimized cost. We explain why developing end-to-end omnichannel capabilities is becoming critical in these uncertain times.

We conclude this special edition with ‘Hitting top speed’, a section that details strategies for identifying new pockets of growth. COVID-19 has further moderated domestic economic activity, meaning companies can no longer rely on strong macro-economic growth to expand. We reveal the keys to engaging with China’s Generation Z, the cohort of digital native consumers driving the next wave of consumption growth. Finally, we detail how consumer packaged goods (CPG) companies can achieve sustainable growth through revenue growth management.

Our clients often ask us, “What is the next China?” This special edition report makes one thing clear: There is no “next China”. China’s economy is unique, and is set to retain its pre-eminent role as the engine of global consumption growth post-pandemic. Companies will require a focused strategy if they wish to continue playing a part in what many would argue is the world’s most exciting consumer story.



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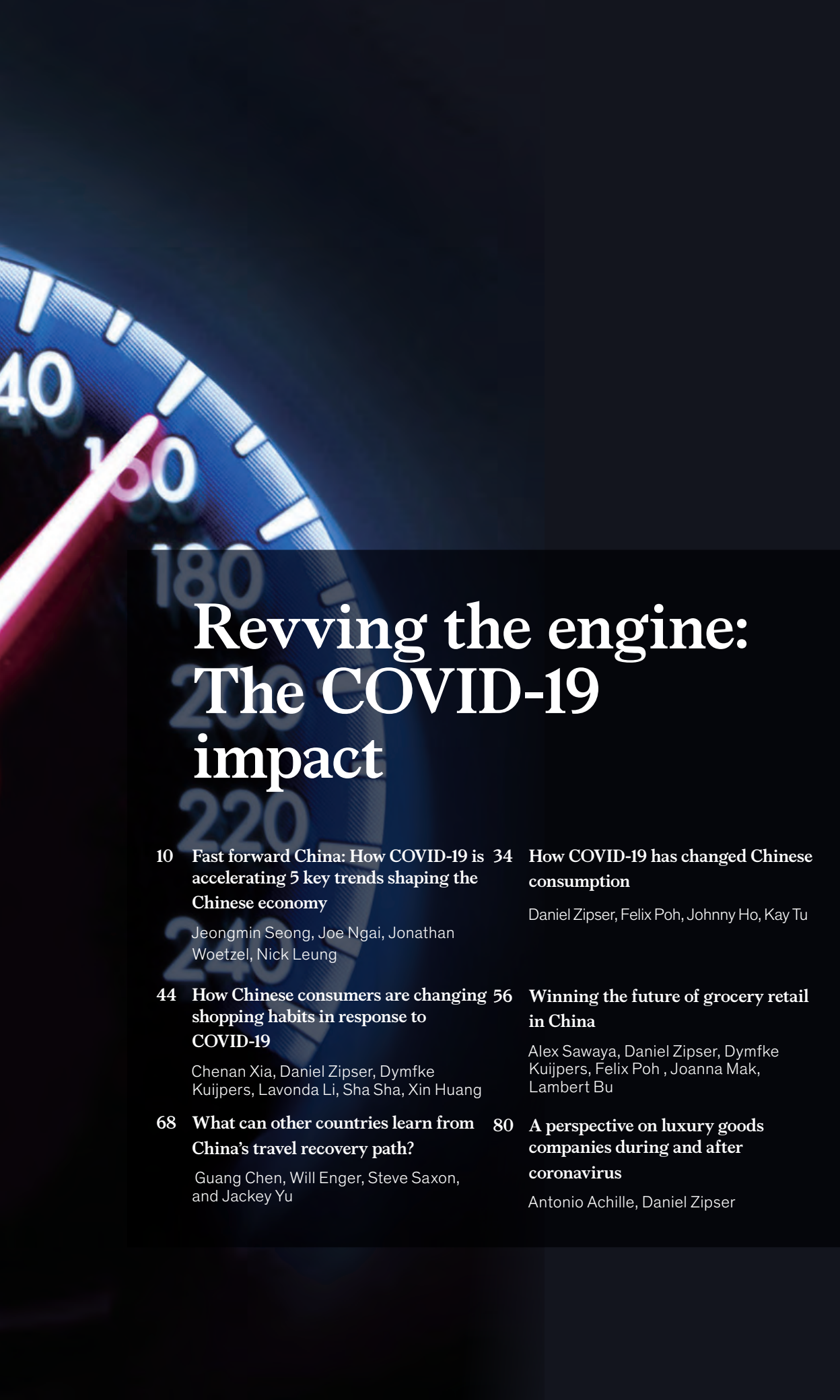

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Fast forward China: How COVID-19 is accelerating 5 key trends shaping the Chinese economy

Jeongmin Seong, Joe Ngai, Jonathan Woetzel, Nick Leung

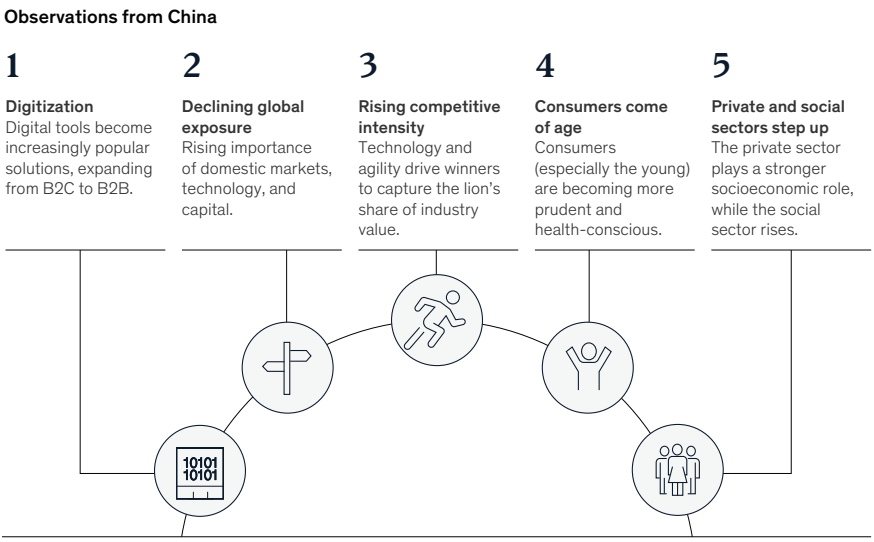
Over the last few months, COVID-19 has spread across the world, uniting humanity in a shared experience that has highlighted the vulnerability of our societies. As the first country to grapple with the crisis, China has been on the frontlines both of post-COVID-19 economic recovery, and of the societal changes the pandemic has precipitated. Efforts to stabilize the domestic economy are already well underway, and though China's first-quarter gross domestic product declined 6.8 percent over the previous year, according to government statistics, our simulations suggest that economic activity may have bottomed out in the first quarter.[1]

As that recovery takes shape, several important shifts in the make-up of China's economic landscape have already become apparent. COVID-19 has accelerated pre-existing trends, ushering in the arrival of a future we were likely already on track to realize. In this report, we discuss five trends shaping the Chinese economy that have been accelerated, or "fast forwarded", as a result of the onset of the COVID-19 crisis (Exhibit 1).

[1] Sven Smit, Martin Hirt, Kevin Buehler, Susan Lund, Ezra Greenberg, and Arvind Govindarajan, *Safeguarding our lives and our livelihoods: The imperative of our time*, March 2020, https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/safeguarding-our-lives-and-our-livelihoods-the-imperative-of-our-time

Exhibit 1

Five accelerating trends in China since COVID-19


Observations from China
1
Digitization
Digital tools become increasingly popular solutions, expanding from B2C to B2B.
2
Declining global exposure
Rising importance of domestic markets, technology, and capital.
3
Rising competitive intensity
Technology and agility drive winners to capture the lion's share of industry value.
4
Consumers come of age
Consumers (especially the young) are becoming more prudent and health-conscious.
5
Private and social sectors step up
The private sector plays a stronger socioeconomic role, while the social sector rises.
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Source: McKinsey analysis

Fast forward trend 1: Digitization

COVID-19 has not only accelerated digitization in business-to-consumer (B2C) applications and channels, but also the traditionally less digitized part of the economy, such as areas requiring physical interactions, and business-to-business (B2B) processes.

Before COVID-19, China was already a digital leader in consumer-facing areas—accounting for 45 percent of global e-commerce transactions while mobile payments penetration was three times higher than that of the US. Consumers and businesses in China have accelerated their use of digital technologies as a result of COVID-19. Based on our mobile surveys of Chinese consumers, about 55 percent are likely to continue buying more groceries online after the peak of the crisis. Nike's first-quarter digital sales in China increased 30 percent on year after the company launched home workouts via its mobile app, while property platform Beike said agent-facilitated property viewings on its virtual reality showroom in February increased by almost 35 times compared with the previous month.

Working practices also changed significantly: Enterprise communication platform DingTalk more than doubled its monthly active users in a single quarter to 177 million. In healthcare, digital interactions accelerated—the rapid growth of online consultations, partly thanks to a regulatory shift in reimbursement policy, as well as broader virtual interactions between pharmaceutical sales agents and physicians. These changes occurred ahead of wide deployment of 5G technology, which will likely catalyze the use of digital tools.

Fast forward trend 2: Declining global exposure

A mix of geopolitical and economic forces was already driving a change in the relationship between China and the world, and COVID-19 appears to be accelerating this trend.

Before COVID-19, China had been reducing its relative exposure to the world as the majority of economic growth was generated by domestic consumption, supply chains matured and localized, and its innovation capabilities were enhanced. The US-China trade dispute raised risks and uncertainties, and about 30 to 50 percent of companies surveyed by various institutions in 2019 indicated that they were considering adjusting their supply chain strategies by seeking alternative sources or relocating production to other geographies. COVID-19 has intensified the debate, with several governments calling for companies in critical sectors to relocate their operations back to their home countries and announcing financial support packages to facilitate this. Twenty percent of companies surveyed by AmCham China believe COVID-19 may accelerate “decoupling”. A paper published in February by the European Union Chamber of Commerce highlighted how diversification is now at the top of the agenda for many European companies in China. Global trade and investment has slowed sharply, and the movement of people has become highly restricted.

Despite these trends, the full picture is more nuanced. Given the size and the growth potential of the Chinese market, investing in a supply chain and innovation footprint to serve China will continue to remain important. And China for its part will continue to require global technology inputs in order to maintain productivity growth. The relationship between China and the world will be a function of the decisions that all parties make over the course of the next several months and years.

Fast forward trend 3: Rising competitive intensity

China’s leading companies retain an outsize share of profits and return on investment, but cut-throat competition threatens their position. COVID-19 will raise competitive intensity, creating even bigger rewards, and risks, for companies in China.

In China, the top decile of companies capture about 90 percent of total economic profit, while the ratio is about 70 percent for the rest of the world, according to our analysis of the world's top 5,000 companies. This leading cohort is comprised of companies that have already digitized and possess highly agile operations, strengths that served them well during the epidemic. For example, Alibaba's Freshippo supermarkets surmounted supply constraints and met soaring online orders for fruit. Foxconn's agility allowed it to switch factory operations to mask production, protecting employees, and enabling resumption of production earlier than competitors. Popular short-video platform TikTok announced it was hiring 10,000 new employees when the virus hit a peak. At the other end of the spectrum, weaker companies, particularly SMEs that are not sufficiently agile or digital-savvy, are vulnerable to cashflow issues, unemployment, and business failure.

Fast forward trend 4: Consumers come of age

China's affluent younger generation had never experienced a domestic economic downturn prior to COVID-19. The virus has forced them to think harder about spending, saving, and trade-offs in purchasing behavior.

Attitudes to spending among consumers in their 20s and 30s, traditionally the engine of China's consumption growth, have changed markedly in the wake of COVID-19. One survey showed 42 percent of young consumers intend to save more as a result of the virus. Consumer lending has also declined, while four out of five Chinese consumers intend to purchase more insurance products post-crisis. Savings have also rocketed—the country's household deposit balance increased by 8 percent over the first quarter to reach 87.8 trillion RMB. Meanwhile, 41 percent of consumers said they planned to increase sources of income through wealth management, investments, and mutual funds.

The virus has also forced purchasing trade-offs, with consumers seeking better quality and healthier options: More than 70 percent of respondents in our COVID-19 consumer survey will continue to spend more time and money purchasing safe and eco-friendly products, while three-quarters want to eat more healthily after the crisis.

Fast forward trend 5: Private and social sectors step up

During the 2003 SARS outbreak, the government and state-owned enterprises (SOEs) were the primary actors during the economic recovery. Now, the private sector and leading technology companies are playing a more significant role, making large socioeconomic contributions amid the emergence of powerful social institutions that have donated millions to recovery efforts. Policy debates also indicate COVID-19 might be accelerating long-awaited structural reforms to land, labor, and capital markets.

In the wake of the 2003 SARS outbreak, SOEs were the major driver of China's economy, accounting for about 55 percent of China's assets, and 45 percent of profits. Today, the private sector contributes close to two-thirds of China's economic growth, and 90 percent of new jobs, illustrating a significant shift in the balance of economic power. In the wake of COVID-19, joint efforts between government and large private companies have played a leading role. For example, Alipay and WeChat supported the Shanghai government's "Suishenma" health QR code launch to help contain the spread of the virus.

These actions illustrate the growth of the private sector, its ability to participate in activities of national importance, and the potential of public-private partnerships. Meanwhile, social institutions including the Bill & Melinda Gates Foundation and the Vanke Foundation have donated millions of dollars to aid recovery efforts. We expect social institutions like these to play a vital role in shaping Chinese society going forward.

In the rest of this report, we explore in more depth how five key trends that have been shaping the Chinese economy have been accelerated by the onset of the COVID-19 crisis.

Fast forward trend 1: Digitization

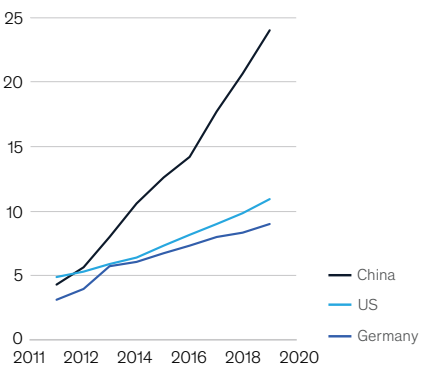
Even before the onset of COVID-19, China was a global front-runner in terms of the digital economy.[2] Now, digitization is not only accelerating in the typical business-to-consumer (B2C) applications and channels, but is also gaining traction in the traditionally less digitized part of the economy, such as areas requiring heavy physical interactions and business-to-business (B2B) processes (Exhibit 2).

Exhibit 2

Digitization

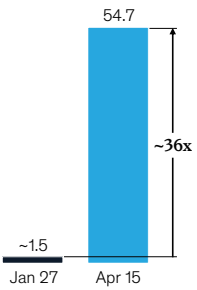
China has long been a global leader in the digital economy

E-commerce as share of total retail value, %

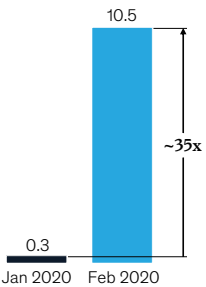


Consumers and businesses have accelerated their use of digital since COVID-19

Online medical consultations, WeDoctor number of registered doctors on their free consultation platform (in K)



Virtual property "showrooms", Beike VR virtual property showing sessions between agents and prospective buyers (in Mn)



Source: iResearch and MOFCOM for China; eMarketer for other countries; literature search; McKinsey analysis

China's digital ecosystem is arguably the most sophisticated in the world, with more than 850 million internet users, and a quarter of the world's startups valued in excess of a billion dollars. Mobile payment penetration is triple that of the United States, while e-commerce accounted for 24 percent of total retail sales in 2019, compared with 9 percent in Germany, and 11 percent in the US. Indeed, China is the world's largest e-commerce market, accounting for about 45 percent of global retail e-commerce transaction value in 2018.

[2] Kevin Wei Wang, Jonathan Woetzel, Jeongmin Seong, James Manyika, Michael Chui, and Wendy Wong, *Digital China: Powering the economy to global competitiveness*, McKinsey, December, 2017.

Prior to COVID-19, the continuous pursuit of innovation by large technology companies and venture-capital investment in key digital technologies, drove the rapid evolution of China's digital landscape. The virus outbreak, meanwhile, has driven the emergence of new digital solutions necessary for companies and consumers forced to observe physical distancing, driving rapid growth of a "stay-at-home economy", and transforming consumer and employee behavior in ways that are likely to endure.

COVID-19 has accelerated digital developments in three key areas:

— B2C interactions, particularly via online channels. Based on a mobile survey of Chinese consumers conducted before, during, and after the peak of the epidemic in China, about 55 percent of consumers are likely to continue buying more groceries online after the peak of the crisis.[3] According to our COVID-19 mobile survey, 74 percent of Chinese citizens increased their online grocery visit frequency during the epidemic, and 15 percent report that they will increase visits after its peak has passed. B2C companies with established digital solutions were able to take advantage of the shift to digital channels, and outperformed peers. For example, Nike hosted workouts for housebound consumers on its mobile apps, stoking demand and driving an 80-percent increase in engagement, as well as a more-than-30-percent increase in first-quarter digital sales in China.[4] Meanwhile, Lululemon deployed a WeChat marketing strategy that increased customer acquisition during the epidemic, leading company management to adopt similar digital engagement models in other regions as a result.[5] Automakers have also taken to launching live stream videos on platforms like TikTok, Alibaba's Tmall, and their own mobile apps, using the digital channel to introduce models and features to consumers, field questions, and sell vehicles, which in some cases are then driven directly to consumers' homes.[6] Since the epidemic began, Taobao has registered 30,000 live-streaming merchant accounts every day, leading to a sevenfold growth in accounts.[7]

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[3] Julien Boudet, Jonathan Gordon, Brian Gregg, Jesko Perrey, and Kelsey Robinson, *How marketing leaders can both manage the coronavirus crisis and plan for the future*, McKinsey, April, 2020.

[4] Jeremy Bowman, *3 Reasons Why Nike Can Overcome the Coronavirus Crisis*, Nasdaq, March 29, 2020, https://www.nasdaq.com/articles/3-reasons-why-nike-can-overcome-the-coronavirus-crisis-2020-03-29.

[5] Samantha McDonald, *Why Lululemon Is Winning Despite the Coronavirus Crisis*, FN, March 27, 2020, https://footwearnews.com/2020/business/earnings/lululemon-coronavirus-sales-earnings-q4-2019-1202955393/.

[6] Hu Yumo, *Automakers go online as COVID-19 hurts sales*, SHINE, February 28, 2020, https://www.shine.cn/biz/auto/2002283070/.

[7] Alibaba: *In February, there were more than 30,000 people opening new stores in Taobao every day*, Sina, February 14, 2020, http://finance.sina.com.cn/stock/relnews/us/2020-02-14/doc-iimxxstf1374236.shtml; *Monthly report of Taobao livestreaming*, ChinaZ.com, March 4, 2020, https://www.chinaz.com/2020/0304/1114695.shtml.

— B2C sectors that traditionally rely on physical interactions. During the lockdown period, companies deployed an array of digital tools to stay connected with customers, even in sectors that traditionally rely on physical interactions. For instance, a leading real estate company launched "virtual showrooms" and online consultations through a dedicated WeChat mini program. In tandem, a dedicated digital salesforce helped deepen relationships with customers, forging connections that will likely outlast the epidemic. Beike, a multi-service property platform, has seen the number of agent-facilitated property viewing sessions on its virtual reality showroom increase by almost 35 times month-on-month in February.[8] Traditional face-to-face medical consultations were also digitized. The Ping An Good Doctor medical consultation platform attracted 1.11 billion visits during the lockdown period.[9] In the process, its registered user base rose tenfold, and the number of daily medical consultations for new app users was nine times higher than before Chinese New Year.[10] Tencent-backed WeDoctor rolled out a free online medical consultation program at the start of the outbreak, and the number of doctors supporting the platform has grown from roughly 1,500 in late January to more than 54,000 in April.[11]

— Business processes. Traditionally, business-to-business (B2B) operations and engagement models demand face-to-face interactions. During COVID-19, several digital processes were introduced that fundamentally changed industry dynamics. The increased use of remote working applications is stark—enterprise communication platform DingTalk's monthly active users rose from about 65 million at the end of 2019, to roughly 177 million by March 2020—a more than 1.7-times increase.[12] Elsewhere, Chinese insurers allowed virtual client meetings to count towards life insurance agents' key performance indicators, whereas previously only face-to-face meetings were considered. Pharmaceutical sales agents were able to meet with physicians online instead of in-person, opening the door to further such interactions in future. Moreover, telecom companies in China have maintained their 2020 5G development targets despite the outbreak, suggesting that digital tools for remote work and interactions will likely continue to proliferate rapidly, catalysed by next-generation communications infrastructure.[13]

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[8] SUN Mengmeng, SUNAC, *Evergrande projects going strong in online sales, Beike VR property sales reshapes new property sales value chain*, Xinhua, March 13, 2020, http://www.xinhuanet.com/house/2020-03-13/c_1125706856.htm.

[9] Ping An Good Doctor, *Ping An Good Doctor Issues 2019 Sustainable Development Report Platform Visits Hit 1.11 Billion During Epidemic*, PR Newswire, February 17, 2020, https://www.prnewswire.com/news-releases/ping-an-good-doctor-issues-2019-sustainable-development-report-platform-visits-hit-1-11-billion-during-epidemic-301005828.html.

[10] Ping An Good Doctor, *Ping An Good Doctor 2019 Performance*, Ping An Good Doctor official website, February 11, 2020, http://www.pagd.net/media/pdf/cn/2019an/2019_AN_CN.PDF.

[11] ZHANG Lijuan, *Internet hospital helps epidemic control, WeDoctor opens up medical emergency relief "from the skies"*, Science and Technology Daily, February 20, 2020, http://stdaily.com/rgzn/yiliao/2020-02/20/content_883651.shtml; Tackling the epidemic: WeDoctor leads digital healthcare upgrade, China.com, April 15, 2020, https://tech.china.com/article/20200415/042020_498997.html.

[12] Analysys Qianfan, 2020 March Mobile App Top 1000, Analysys Qianfan, retrieved April 23, 2020, https://qianfan.analysys.cn/refine/view/rankApp/rankApp.html; Analysys Qianfan, 2019 December Mobile App Top 1000, Analysys Qianfan's official post on Zhihu, January 16, 2020, https://zhuanlan.zhihu.com/p/102983491.

[13] LING Jiwei, *Sector pulse under the epidemic: China's 5G commercialization pace is not slowing*, Xinhua, March 3, 2020, http://www.xinhuanet.com/tech/2020-03/03/c_1125656066.htm.

Fast forward trend 2: Declining global exposure

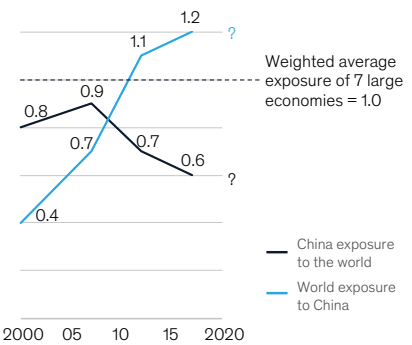
Over the last decade, the engine of the Chinese economy has become more domestically driven by the rapid expansion of its consumer market, deep localization of supply chains, and strong emphasis on local innovation. As a result, China's relative exposure to the rest of the world in terms of people, capital, and technology has declined. Meanwhile, the rest of the world's exposure to China, which has increased at a steady pace over the past decade, in part as a result of the globalization of supply chains, as well as the expansion of the Chinese middle class, is now in question. The forces that were already driving a restructuring of the relationship between China and the global economy may with COVID-19 be accelerating this trend on a global scale (Exhibit 3).

Exhibit 3

Declining global exposure

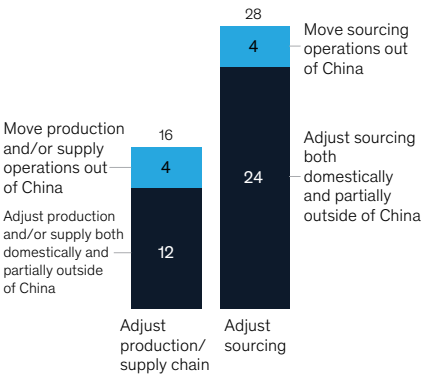
China has been reducing its relative exposure to the world

MGI China-World Exposure Index
(trade, technology, and capital)



Diversification strategy is likely to remain important post-COVID-19

AmCham China survey respondents, April 2020, %



Source: McKinsey Global Institute; American Chamber of Commerce survey

According to the McKinsey Global Institute (MGI) China-World Exposure Index, in the decade to 2017, China's exposure to the world in terms of trade, technology, and capital has fallen in relative terms even as the rest of the world's exposure to China has increased. China's indexed exposure to the world decreased from 0.9 in 2007 to 0.6 in 2017, while the world's exposure to China increased from 0.7 to 1.2 in the same period.[14]

The rest of the world's increased exposure is in part a reflection of the rising importance of China as a consumer market, and as a source of capital and goods. However, changes in the international context have made diversification of manufacturing and supply chains an important strategy for businesses around the world.

According to a survey of executives at multinational companies based in China conducted by the American Chamber of Commerce in 2019, nearly 40 percent of companies have considered moving production out of China to other geographies including emerging markets in Southeast Asia. Two-thirds cited the imposition of tariffs stemming from the trade dispute between the US and China as the primary reason for considering whether to relocate manufacturing.[15] A paper published in February by the European Union Commerce of Chamber highlighted how diversification is now at the top of the agenda for many European companies in China.

Meanwhile, China's relative exposure to the rest of the world has declined because the major driver of its economic expansion is no longer trade and investment, but domestic consumption, which accounts for 60 to 70 percent of China's GDP growth.[16] This is evidenced by the decline in China's trade surplus as a percentage of GDP from 8.7 percent in 2007 to 0.8 percent in 2018.[17] Moreover, as China's consumer market and domestic supply chains have matured, more goods and services are being produced and consumed domestically, leading to a decline in the proportion exported. China exported 28 percent of its output of personal computers and electronics in 2017, compared with 55 percent in 2007.[18] In short, China is becoming more localized, or more Chinese, as the rest of the world has absorbed more Chinese influence. However, some parts of China's technology value chain are still dependent on the rest of the world. For example, the value of China's intellectual property (IP) imports are six times higher than its IP exports.[19] As a result, China's

[14] A value greater than 1.0 suggests the world is more exposed to China than to the economies of China, Japan, Germany, France, India, United Kingdom, and the United States, on average, whereas a value less than 1.0 suggests the world is less exposed to China than to the seven large economies.

[15] *Second Joint Survey on the Impact of Tariffs*, American Chamber of Commerce, May 22, 2019, https://www.amchamchina.org/about/press-center/amcham-statement/second-joint-survey-on-the-impact-of-tariffs.

[16] Zhang Jie, *Consumption remains biggest contributor to economic growth*, China Daily, July 30, 2019, http://www.chinadaily.com.cn/a/201907/30/WS5d3fe0e0a310d83056401c6e.html.

[17] Jonathan Woetzel, Jeongmin Seong, Nick Leung, Joe Ngai, James Manyika, Anu Madgavkar, Susan Lund, and Andrey Mironenko, *China and the world: Inside the dynamics of a changing relationship*, McKinsey, July, 2019.

[18] Susan Lund, James Manyika, Jonathan Woetzel, Jacques Bughin, Mekala Krishnan, Jeongmin Seong, and Mac Muir, *Globalization in transition: The future of trade and value chains*, McKinsey, January, 2019.

[19] Jonathan Woetzel, Jeongmin Seong, Nick Leung, Joe Ngai, James Manyika, Anu Madgavkar, Susan Lund, and Andrey Mironenko, *China and the world: Inside the dynamics of a changing relationship*, McKinsey, July, 2019.

government has promoted policies designed to reduce technological reliance on the rest of the world which has sometimes led to the cultivation of a different technology ecosystem, like China's unique suite of mobile apps that have a range of functionality that may not be found in the West.

The COVID-19 outbreak has intensified the debate over whether companies should relocate or localize their supply chains, amid calls for companies in critical sectors to move production capacity out of China. Meanwhile, restrictions on movement imposed to prevent transmission of the virus have slowed global trade flows, sparking a debate on the direction of globalization.

Three observations that indicate COVID-19 has prompted a restructuring of the China-world relationship:

Changing sentiment among US companies and consumers. More US companies are anticipating an acceleration of the need to diversify risk. In a March survey led by the American Chamber of Commerce in China, 44 percent of respondents said it is impossible for the two economies to "decouple", down from two-thirds in the October 2019 survey, while 20 percent said they expect "decoupling" to accelerate as a result of COVID-19. Risk diversification is likely to remain as an important strategy post-COVID-19. As a result of the outbreak, 16 percent of US companies indicated they will at least partially move production and/or supply chain operations outside of China, and 28 percent are making similar adjustments regarding sourcing.[20] The share of American consumers expressing an unfavorable opinion of China has also increased, according to a survey conducted in March by the Pew Research Center.[21]

Increased incentives to relocate and localize. Several government leaders are calling for a reshoring of supply chains as a result of COVID-19. For example, Japan has earmarked $2.2 billion to help its manufacturers shift production out of China.[22] US lawmakers have also raised concerns over the national security implications of sourcing medical supplies in China[23], while Australian politicians have advocated for reduced dependence on China and a diversification of supply chains.[24] On the other hand, a number of policies and initiatives recently announced by the Chinese government indicate the importance of encouraging foreign enterprises to continue their investments and business operations in the country. For example, on April 1, the Ministry of Commerce (MOFCOM) released the 'Circular on Further Expanding Reform and Opening up to Stabilise Foreign Investment', which includes 24 measures to promote foreign investment flows into China.[25]

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[20] A value greater than 1.0 suggests the world is more exposed to China than to the economies of China, Japan, Germany, France, India, United Kingdom, and the United States, on average, whereas a value less than 1.0 suggests the world is less exposed to China than to the seven large economies.

[21] *Second Joint Survey on the Impact of Tariffs*, American Chamber of Commerce, May 22, 2019, https://www.amchamchina.org/about/press-center/amcham-statement/second-joint-survey-on-the-impact-of-tariffs.

[22] Zhang Jie, *Consumption remains biggest contributor to economic growth*, China Daily, July 30, 1029 , http://www.chinadaily.com.cn/a/201907/30/WS5d3fe0e0a310d83056401c6e.html.

[23] *US lawmakers push to reclaim medical supply chains from China*, Financial Times, April 2, 2020, https://www.ft.com/content/d71c01db-5333-470b-abcd-0df126864447.

[24] *Coronavirus shortages prompt Australia to bring manufacturing home*, Financial Times, April 15, 2020, https://www.ft.com/content/04ac783d-8ced-4e66-9437-78b607cbd8d4.

Increasing restrictions on mobility and trade. The World Trade Organization (WTO) has forecast global trade may decline by 13 to 32 percent in 2020 as a result of virus containment measures, higher than the 12.5 percent contraction experienced at the height of the financial crisis in 2009.[26] Foreign direct investment (FDI) is also likely to slump, with the United Nations Conference on Trade and Development forecasting global FDI to shrink 5 to 15 percent in 2020-21.[27] Based on WTO data, trade restrictions have also increased, with 38 countries rolling out 56 restrictive trade policies since the COVID-19 outbreak.[28] People flows are also severely constrained, with 90 percent of the world's population living in countries with entry restrictions on non-citizens and non-residents.[29] More than 90 World Health Organization (WHO) members have imposed restrictions on travel to China as of end-March this year, compared with 29 at the end of January.[30] The mobility restrictions also prevent companies from undertaking mergers and acquisitions as due diligence processes and negotiations will likely be postponed as a result of travel restrictions.

Despite these trends, the full picture is more nuanced. While some companies might benefit from diversifying risks in their supply chains, this does not mean that companies and investors will rush to leave China overnight. China has contributed about 25 percent of global GDP growth over the past two decades, and the latest International Monetary Fund forecast suggests that even as 90 percent of the world experiences negative GDP growth in 2020, China's economy may still expand by 1.2 percent.[31] As such, China is likely to remain an important growth engine for the world, and the extensive supply chains that have evolved to serve domestic demand will continue to be needed. Moreover, few countries possess the mature and highly scaled production ecosystems that exist in China. At the same time, China will continue to require global technology inputs in order to maintain productivity growth. The decisions taken by China and the rest of the world over the next few months and years will determine the trajectory of the relationship.

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[25] *Ministry of Commerce, The Ministry of Commerce Holds Online Press Conference on Responding to the Epidemic and Stabilizing Foreign Investment, April 4, 2020,* http://english.mofcom.gov.cn/article/newsrelease/press/202004/20200402953246.shtml.

[26] *Trade set to plunge as COVID-19 pandemic upends global economy*, World Trade Organization, April 8, 2020, https://www.wto.org/english/news_e/pres20_e/pr855_e.htm.

[27] *Coronavirus could shrink global FDI by 5% to 15%*, United Nations Conference on Trade and Development, March 8, 2020, https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2299.

[28] Data from *COVID-19: Trade and Trade-related Measures*, World Trade Organization, retrieved April 23, 2020, https://www.wto.org/english/tratop_e/covid19_e/trade_related_goods_measure_e.htm.

[29] Phillip Connor, *More than nine-in-ten people worldwide live in countries with travel restrictions amid COVID-19*, Pew Research Center, April 1, 2020, https://www.pewresearch.org/fact-tank/2020/04/01/more-than-nine-in-ten-people-worldwide-live-in-countries-with-travel-restrictions-amid-covid-19/.

[30] Samantha Kiernan and Madeleine DeVita, *Travel Restrictions on China due to COVID-19*, Think Global Health, April 6, 2020, https://www.thinkglobalhealth.org/article/travel-restrictions-china-due-covid-19.

[31] Gita Gopinath, *The Great Lockdown: Worst Economic Downturn Since the Great Depression*, International Monetary Fund, April 14, 2020, https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/.

Fast forward trend 3: Rising competitive intensity

China's leading companies have secured an outsize share of economic profit and return on investment, but cut-throat competition means their dominance is often short-lived. COVID-19 will raise competitive intensity, creating even bigger rewards, and risks, for market-leading companies (Exhibit 4).

Exhibit 4

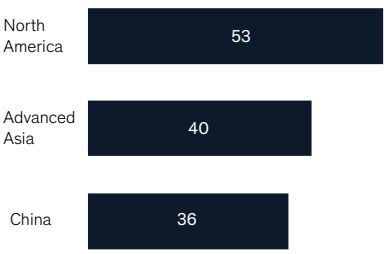
Rising competitive intensity

In China, top performing firms tend to capture a large share of economic profit

Economic profits generated by each decile company group in China, Cumulative basis, 2015-17 $ Bn[1]

Leadership is highly contested in China

Likelihood of staying at the top quintile over a decade[1], %



[1] Analysis of global top 5,000 companies based on revenue size
[2] Economic profit measures a company's profit after subtracting the cost of capital
Source: McKinsey Corporate Performance Analytics; McKinsey Global Institute analysis

In China, the top decile of companies capture about 90 percent of total profit in the economy, while the ratio stands at about 70 percent for the rest of the world according to our analysis of the world's top 5,000 companies. This leading cohort outperforms the rest of the market by a large margin, as their return on invested capital is at 14.6 percent, more than twice the average of 6.8 percent. On the other hand, China has a long tail of underperformers—starting from the 40th percentile onward, the value of economic profit generated by Chinese companies starts to decline. Strong performers in the top decile tend to have robust digital capabilities, as well as agility, and high labor productivity. However, top performers in China cannot be complacent as leadership is highly contested. Only 36 percent of the firms in the top quintile in China were able to protect their position over a period of 10 years, compared with 53 percent in North America.

The "superstar effect" appears to be growing even more pronounced as a result of COVID-19. Under epidemic conditions, when the economy was in retreat, agile and digitally savvy players were able to identify business opportunities to gain share. Chinese internet companies are a case in point. Meanwhile, the epidemic has triggered a flight to quality among consumers keen to ensure they obtain safe and healthy products, empowering companies that offer such benefits.

On the other hand, some endured strong headwinds. Constraints on resources, a lack of agility, or their inability to go digital made them slow to react, resulting in a decline in business, and cash flow issues. For many, the consequence has been reductions in headcount or working hours, coupled with salary cuts. COVID-19 has moreover, highlighted inequality among employees; those in some sectors and with less agility are vulnerable while others are not.

The rising competitive intensity as a result of COVID-19 is evident across three key areas:

— **Agile companies increasing customer relationships and sales.** Package delivery provider SF Express leveraged its own fleet during the outbreak, which minimized operational disruptions even as competitors, reliant on franchise models with more outsourced labor, were harder hit by supply disruptions. As a result, SF Express reported sales volume doubled during the peak of COVID-19 in China.[32] Foxconn, one of the world's largest contract manufacturers of consumer electronics, reacted fast when most factories in China were forced to shut down. By switching some of their product lines to produce masks, they protected their workers' health and livelihoods and lowered the risk of production interruptions due to the virus.[33] In part due to these measures, Foxconn was able to resume 100 percent of their production capacity in its Chengdu factory in March.[34]

[32] Western Securities Co, *Courier industry in February 2020*, Tencent Security, March 20, 2020, http://gu.qq.com/resources/shy/news/detail-v2/index.html#/?id=nesSN20200320090100792 1a0a9&s=b.

[33] Rob Davies, *Foxconn makes masks for its iPhone workers amid coronavirus crisis*, The Guardians, February 7, 2020, https://www.theguardian.com/technology/2020/feb/07/foxconn-makes-masks-for-its-iphone-workers-amid-coronavirus-crisis-apple.

[34] *Foxconn Shezhen shipped 4 million masks*. Foxconn Chengdu fully resumed production, Apple Daily, March 3, 2020 https://hk.appledaily.com/china/20200303/QZSSAFMXPDXZOM4MJFTYUW5DMA/.

Tech savvy companies continuing to expand. The heightened popularity of social media during the lockdown spurred development of companies such as ByteDance, parent company of video-streaming platform TikTok, which announced it was hiring 10,000 new employees around the world.[35] With more than 100 million downloads, TikTok was the world's most-downloaded app in January 2020, just as COVID-19 intensified in China.[36] As a supermarket brand with strong digital exposure, Alibaba's Freshippo was able to overcome supply constraints and meet soaring online orders for fruit.[37] The company even hired thousands of extra staff furloughed by shops and restaurants, allowing them to outperform their traditional supermarket peers. Domestic cosmetic brand, Perfect Diary, turned makeup artists in 50 offline stores into online 'KOLs' through WeChat and livestreaming apps during COVID-19, resulting in more than 140,000 livestreaming views, and ranking top among Taobao-listed cosmetic products.[38]

Cashflow troubles for weaker companies. Some sectors and companies struggled to sustain businesses during the epidemic. According to a survey of small- and medium-sized companies (SMEs) by Peking University in February, around 20 percent of respondents said they would not be able to endure beyond a month on a cashflow basis, while 60 percent would not last beyond a quarter, should the pandemic have continued.[39] While some of these SMEs may have already bounced back given recent signs of recovery, based on China Banking Regulatory Commission information, non-performing loans increased by 0.06% at the end of February versus the beginning of the year.[40]

This divergent performance across sectors and companies has a knock-on effect on employees. Staff in companies that are not sufficiently agile or digital-savvy to change the way they work in response to market shocks are vulnerable to unemployment. This is especially true in China, though significant financial resources are directed towards helping companies reduce the risk of job losses, and the government is supporting vulnerable companies via the banking system. For example, the bank ICBC extended various forms of financial support to SMEs facing business difficulties during the epidemic.[41]

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[35] Wei Sheng, *Bytedance is hiring 10,000 workers as global tech firms slash jobs*, Technode, April 15, 2020, https://technode.com/2020/04/15/bytedance-is-hiring-10000-workers-as-global-tech-firms-slash-jobs/.

[36] *TikTok tops the list of most downloaded apps in January 2020, Hindustan Times, March 20, 2020,* https://www.hindustantimes.com/tech/tiktok-tops-the-list-of-most-downloaded-apps-in-january-2020/story-dm23tPCrC2eA5cN9KSzzXN.html.

[37] Josh Horwitz, *How Alibaba's Freshippo adapted to keep delivering in virus-hit China*, Reuters, March 24, 2020, https://www.reuters.com/article/us-health-coronavirus-alibaba-freshippo/how-alibabas-freshippo-adapted-to-keep-delivering-in-virus-hit-china-idUSKBN21A0W0.

[38] *Consumption report during COVID-19: Cosmetic—how companies leverage livestreaming*, Beijing Business Today, April 19, 2020, https://baijiahao.baidu.com/s?id=1664367865765114123&wfr=spider&for=pc.

[39] Rouchen Dai , Junpeng Hu and Xiaobo Zhang, *The Impact of Coronavirus on China's SMEs: Findings from the Enterprise Survey for Innovation and Entrepreneurship in China*, Center for Global Development, February 28, 2020, https://www.cgdev.org/publication/impact-coronavirus-chinas-smes-findings-from-esiec.

[40] *China Non Performing Loans Ratio*, CEIC https://www.ceicdata.com/en/indicator/china/non-performing-loans-ratio.

[41] *ICBC Takes Measures to Boost Work Resumption by SMEs*, ICBC, February 28, 2020, https://www.icbc.com.cn/icbc/en/newsupdates/icbc%20news/ICBCTakesMeasurestoBoostWorkResumptionbySMEs.

Fast forward trend 4: Consumers come of age

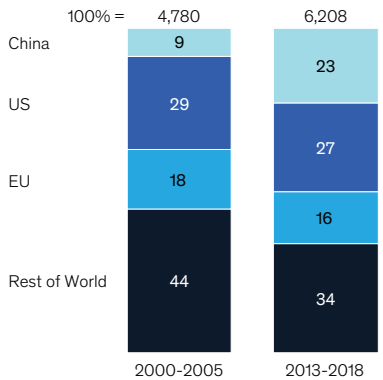
Chinese consumers have long been a major driver of global consumption, especially the affluent younger generation who have never experienced a domestic economic downturn. COVID-19 has changed that, forcing consumers to think harder about spending, borrowing, and trade-offs in purchasing behaviour (Exhibit 5).

Exhibit 5

Consumers come of age

China's consumption power has grown significantly

Global household consumption growth by region, %, billion 2010 US$



Consumers have become more prudent with personal finances since COVID-19

China household deposit balance, RMB Tn

China consumption loan/ consumer credit balance, RMB Tn

Source: National Bureau of Statistics in China; World Bank; People's Bank of China; McKinsey analysis

Over the last two decades, China has successfully increased the role consumption plays in the economy to the point that it is now the driving force behind economic growth. Indeed, China's share of global consumption growth rose from 9 percent in the 2000-2005 period to 23 percent in 2013-2018 (Exhibit 5). China's consumption power is also pronounced in the luxury segment, where Chinese consumers accounted for 32 percent of global consumption in 2018, and are expected to account for 40 percent by 2025.[42] As China's consumer economy has risen, buying behaviour has become more sophisticated. For example, based on our most recent survey of Chinese consumers, 72 percent of respondents indicate they want to pursue a healthy lifestyle, while 60 percent of those in large cities check ingredient labels post-epidemic. Moreover, 24 percent of Chinese consumers intended to trade up their purchases in 2018, higher than the 10-15 percent in developed countries.

Until COVID-19, growth in consumer spending had continued relatively unchecked on a national scale. However, the epidemic has severely disrupted the economy, and triggered profound changes in consumer behavior, including those in their 20s and 30s. This cohort has been the engine of Chinese consumption, with 40-50 percent indicating in a McKinsey consumer survey that they never worry about income because their parents can easily cover expenses. Moreover, 40 percent of respondents aged 20 to 30 indicated that they had received help from their parents when buying an apartment. As a result of COVID-19, many of these consumers experienced a significant blow to their personal finances for the first time, forcing them to make tough trade-offs in terms of purchasing decisions, and driving an almost instant maturation of their spending attitudes and patterns.

The accelerating maturity of Chinese consumers can be seen in four key areas:

— **Young consumers' spending.** Before the epidemic, China's young consumers (defined here as those born in the 90s or after) were more willing to spend than to save. They accounted for one-third of China's consumer credit[43], and almost half of Alibaba's "Ant Check Later" consumer financing platform user base[44], while fewer than 50 percent had consciously put aside retirement savings.[45] However, the epidemic has unlocked their long-term

[42] *McKinsey China Luxury 2019 Report,* https://www.mckinsey.com/~/media/mckinsey/featured%20insights/china/how%20young%20chinese%20consumers%20are%20reshaping%20global%20luxury/mckinsey-china-luxury-report-2019-how-young-chinese-consumers-are-reshaping-global-luxury.ashx.

[43] *2019 China "born-in-the-90s" consumer borrowing overview and behavioral analysis*, iiMedia, December 18, 2019,https://www.iimedia.cn/c1020/67253.html.

[44] *2019 China "born-in-the-90s" consumer borrowing overview and behavioral analysis*, iiMedia, December 18, 2019,https://www.iimedia.cn/c1020/67253.html.

[45] Fidelity and Ant Fortune, *China Retirement Readiness Survey 2019*, September 2019, http://www.fidelity.com.cn/zh-cn/market-insights/china-retirement-readiness-survey-2019-full-report/10/.

[46] China Youth Daily, *Survey shows 66.5% respondents developed good habits during the epidemic*, China News, April 23, 2020,http://www.chinanews.com/sh/2020/04-23/9165443.shtml.

planning behavior, as they come to terms with the prospect of recession for the first time in their working lives. The result has been significant changes in their saving, borrowing, investing, and consumption behavior according to various surveys. For example: In a survey heavily weighted toward young consumers, 42 percent of respondents stated their intention to save more than before COVID-19.[46] Another survey highlights the value of consumer loans primarily extended to young consumers declined by 22 percent between end-2019 and March.[47] In terms of investing, more than 40 percent of new wealth management and stock trading customers are young[48], with about 80 percent indicating an intention to purchase more insurance products after COVID-19.[49] At the same time, they are becoming more cautious. More than 60 percent of young consumers intend to plan their consumption and reduce impulse spending.[50] This is especially true for those born between 1995 and 1999, three-quarters of whom said they intended to do so.

— **Even more prudent personal financial management.** China's household savings rate is about 36 percent, among the highest in the world.[51] Chinese consumers are now putting even more thought into how they manage their personal finances. In the first quarter of 2020, deposit balances increased by 70 billion RMB each day, on average.[52] As a result, the country's household deposit balance increased by 8 percent compared with end-2019, reaching 87.8 trillion RMB at the end of March 2020.[53] A survey on post-coronavirus consumer behavior showed that around 41 percent of respondents plan to increase their sources of income through wealth management, investments, and mutual funds. In addition, approximately 27 percent indicated they will buy health insurance for themselves and their family.[54]

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[46] China Youth Daily, *Survey shows 66.5% respondents developed good habits during the epidemic*, China News, April 23, 2020,http://www.chinanews.com/sh/2020/04-23/9165443.shtml.

[47] *Summary of Sources And Uses of Credit Funds of Financial Institutions*, statistics session of People's Bank of China website, March 2020.

[48] QuestMobile, *2020 Epidemic's Impact on Lifestyle Report*, QuestMobile website, March 25, 2020, https://www.questmobile.com.cn/research/report-new/87.

[49] Rong360.com Inc, *55.99% of respondents reported impact on income during epidemic*, China.com, April 1, 2020, https://m.tech.china.com/tech/article/20200401/042020_490646.html.

[50] 58 Finance, *58 Finance Finance and Consumer Borrowing Attitude Survey Report*, iResearch, April 23, 2020, http://news.iresearch.cn/yx/2020/04/321476.shtml.

[51] *Household savings section*, OECD National Accounts Statistics, https://data.oecd.org/hha/household-savings.htm.

[52] *Daily inflow of 70 billion to banks*, Phoenix New Media, April 15, 2020, https://finance.ifeng.com/c/7vhACPWszOC.

[53] *China reports increase in household deposits*, Xinhua, April 18, 2020 http://www.xinhuanet.com/english/2020-04/18/c_138988659.htm.

[54] *Consumer behavior change during COVID-2019*, Sina, March 10, 2020, http://tech.sina.com.cn/roll/2020-03-10/doc-iimxxstf7737378.shtml.

— **Health conscious purchase decisions.** The epidemic has increased awareness of product safety and quality, and this trend is expected to continue. More than 70 percent of respondents in our COVID-19 consumer survey said they will continue to spend more time and money purchasing safe and eco-friendly products, despite pressure on disposable income as a result of the economic slowdown. As for buying behavior, consumers have over-indexed on healthy products. Around 75 percent of consumers demonstrated strong preference to exercise more and eat healthily post crisis.

— **Purchasing trade-offs amid a flight to quality:** Chinese consumers have become more cautious as a result of the epidemic, tending to spend less but buying better quality products. According to a post-epidemic survey, close to half of Chinese respondents intend to live more frugally and seek value-for-money when selecting products, while 36 percent are more willing to spend more for better quality mproducts.[55] Consumers are potentially seeking quality in their necessities, while focusing on value-for-money in other categories. A survey reveals that post-COVID-19, consumers increased their net purchase intention by the largest degree toward essential, health-oriented products, such as sanitary and health products, fresh food, and life insurance, while expressing negative net purchase intention towards non-necessities such as hair and beauty products, and large home appliances.[56] Consumer complaints relating to quality have also increased. In Guangdong for example, consumer complaints rose 40 percent on year in the first quarter to 98,000, suggesting tolerance for low-quality products and poor service is on the decline.[57]

[55] 58 Finance, *58 Finance Finance and Consumer Borrowing Attitude Survey Report*, iResearch, April 23, 2020, http://news.iresearch.cn/yx/2020/04/321476.shtml.

[56] Netease Dingwei and CTR, *2020 COVID-19 Consumer Behavior Impact and Trends Repor*t, retrieved April 23, 2020,http://pdf.dfcfw.com/pdf/H3_AP202003111376137659_1.pdf.

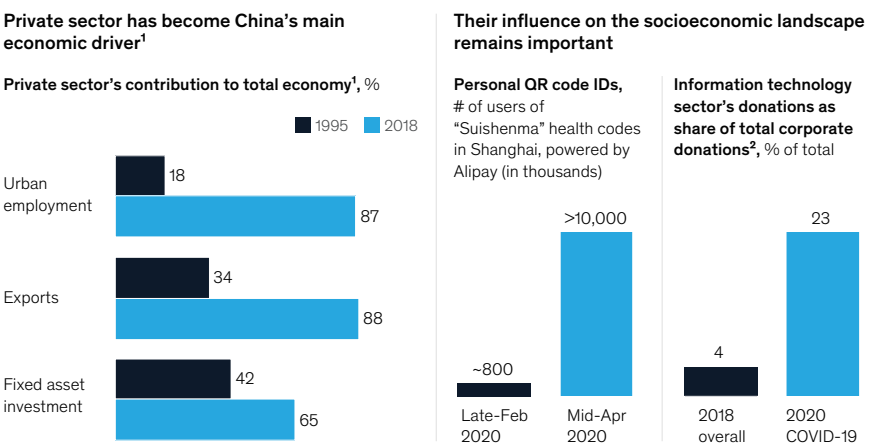
[57] China Consumer News, *Guangdong COVID-19 related consumer complaints increased*, Guangdong Consumer Council, April 16, 2020, http://www.gdcc315.cn/show-9-52867-1.html.

Fast forward trend 5: Private and social sectors step up

During the 2003 SARS outbreak, the government and state-owned enterprises (SOEs) were the primary actors in the economy, and therefore led the country's response to the crisis. China's response to COVID-19, however, has been orchestrated by a blend of state and private institutions. While SOEs again played a critical role, the private sector, in particular leading technology companies, made notable contributions to relief and recovery efforts. Policy debates also indicate COVID-19 might be accelerating long-awaited structural reforms to land, financial, and labor markets (Exhibit 6).

Exhibit 6

Private and social sectors step up



[1] Private enterprises defined as private enterprises and foreign enterprises
[2] 2018 data is from "Giving China 2018" report, where 2020 COVID-19 data is based on announced donation information (up to 24 Feb 2020) from collated online literature. Corporate donations include donations from state-owned enterprises, privately-owned enterprises, and foreign enterprises
Source: CEIC; Giving China 2018; literature search; McKinsey analysis

In 2003, when the State-owned Assets Supervision and Administration Commission (SASAC) was established to orchestrate state-owned enterprise reform, SOEs were still the major driver of China's economy, accounting for about 55 percent of China's assets, and 45 percent of profits.[58] However, private enterprises have now become the major driver of China's economic growth, and the fulcrum of urban employment generation, export value, and fixed-asset investment. Today, the private sector contributes close to two-thirds of China's economic growth, and 90 percent of new jobs.[59]

This context is important in understanding key differences in the responses to SARS in 2003, and COVID-19 in 2020. In 2003, the government led the majority of epidemic prevention and recovery efforts, whereas joint efforts between government and large private companies have come to the fore during COVID-19. The shift illustrates the growth of the private sector, its ability to participate in activities of national importance, and the potential opportunities inherent in public-private partnerships with the state. In addition, the role of social institutions has expanded to address gaps in the corporate and state response, a development which is beneficial to society overall. The government recently announced a policy direction to accelerate structural reforms that cover labor, land, prices, capital, and technology.

The acceleration of changes to the role of the private sector is evident in three key areas:

— **Private sector actors aiding the national recovery with technology and resources.** Technology companies and financial institutions have assisted virus containment efforts, enabling the widespread adoption of a color-coded health system using QR codes, as well as sophisticated track and trace measures. In Shanghai, Alipay and WeChat supported the Shanghai government's "Suishenma" health QR code launch in mid-February to help citizens self-report and trace infections.[60] Users of the system rose from about 800,000 in late February to more than 10 million in mid-April.[61] Alibaba also launched an online appointments platform for new coronavirus nucleic acid testing services in 38 major cities[62], on top of their "2020 Spring Thunder Initiative" to help export-focused SMEs expand

[58] Zoey Ye Zhang, *China's SOE Reforms: What the Latest Round of Reforms Mean for the Market*, China Briefing, March 29, 2020, https://www.china-briefing.com/news/chinas-soe-reform-process/.

[59] Rainer Zitelmann, *State Capitalism? No, The Private Sector Was And Is The Main Driver Of China's Economic Growth*, Forbes , September 30, 2019, https://www.forbes.com/sites/rainerzitelmann/2019/09/30/state-capitalism-no-the-private-sector-was-and-is-the-main-driver-of-chinas-economic-growth/#760e03f827cb/ .

[60] *Shanghai government's "Suishenma" health QR code*, Shanghai Observer, March 1, 2020, https://www.jfdaily.com/news/detail?id=218227.

[61] Ding Yining, *Health QR code made available to more residents*, SHINE, March 1, 2020, https://www.shine.cn/biz/economy/2003013178/.

[62] *Alibaba launches Covid-19 test service in China*, cnTechPost, April 21, 2020,https://cntechpost.com/2020/04/21/alibaba-launches-covid-19-test-service-in-china/.

into new markets through e-commerce channels.[63] Many other companies contributed products, services, money, and technology to support the government and community. For example, Chinese tech firms collectively donated more than $4.4 billion to combat COVID-19, almost a quarter of corporate donations made since the outbreak, and much higher than the 4 percent of total corporate donations the sector contributed in 2018.[64] Alibaba provided free services and offered financial support to Chinese business, while Ping An launched a smart system to bridge doctors and patients.[65] Taikang Insurance accommodated more than 2,000 coronavirus patients in their own hospital, and donated money and goods worth more than 100 million RMB.[66]

— **Policy announcement to strengthen the role of the market.** On March 30, the State Council published a document listing a series of policy directions aimed at boosting the market economy, covering several agenda items requiring deep structural reforms, including for example: land (more flexibility in land use); labor (remove/loosen the household registration system); prices (integration between benchmark lending and deposit rates with market rates); capital (opening up of the financial sector) and technology (global collaboration). While these initiatives were already on the agenda of Chinese policy makers, it appears that COVID-19 might be serving as a catalyst to accelerate the pace of reform.[67]

— **Rising influence of social institutions.** Foundations and other charitable organizations have also become more influential, in keeping with a doubling of social institutions in China between 2009 to 2019.[68] The sector played a vital role in consolidating donations of money and supplies during the outbreak. Collectively, these institutions received more than 29 billion RMB from societal donations, and redirected the funds to areas most in need of help.[69] For instance, the Bill & Melinda Gates Foundation committed

[63] *Alibaba launches 2020 Spring Thunder Initiative to give Chinese SMEs a leg up during Covid-19*, cnTechPost, April 7, 2020, https://www.thedrum.com/news/2020/04/07/alibaba-launches-2020-spring-thunder-initiative-give-chinese-smes-leg-up-during.

[64] *Report on corporate donations on COVID-19 crisis in China*, March 10, 2020, https://xw.qq.com/cmsid/20200310A0ETR700); China Charity Alliance, Giving China 2020, September 2019, http://www.charityalliance.org.cn/u/cms/www/201909/23083734i5wb.pdf.

[65] Ping An Insurance Group Ltd., *Ping An Launches COVID-19 Smart Image-Reading System to Help Control the Epidemic*, PR Newswire, February 28, 2020, https://www.prnewswire.com/news-releases/ping-an-launches-covid-19-smart-image-reading-system-to-help-control-the-epidemic-301013282.html.

[66] *How Tai Kang made a joint effort with domestic and foreign experts to combat coronavirus*, Xinhua, April 19, 2020,http://www.xinhuanet.com/money/2020-04/19/c_1125877007.htm.

[67] *State Council, April 9, 2020,* http://www.gov.cn/zhengce/2020-04/09/content_5500622.htm; *China's Top Leaders Pledge Bigger Role for Markets, April 13, 2020, China's Top Leaders Pledge Bigger Role for Markets,* https://www.bloombergquint.com/china/china-s-top-leaders-pledge-bigger-role-for-markets-as-virus-hits.com/2020/04/21/alibaba-launches-covid-19-test-service-in-china/.

[68] *Quarterly statistics session*, Ministry of Civil Affairs of the People's Republic of China.

[69] *National social donation has achieved 29.2 billion*, China Charity Alliance, March 9, 2020, http://www.charityalliance.org.cn/gov/13362.jhtml.

$5 million to China to combat the virus.[70] Vanke Foundation donated 100 million RMB to Hubei province, where the virus originated and caused the most damage,[71] and Vanke employees' funds granted 200 million shares worth 5.3 billion RMB to Tsinghua University to build the Vanke School of Public Health.[72] The Ford Foundation has made about 300—500 thousand USD worth of grants to NGOs providing a frontline response.[73] Han Hong Love Charity Organization raised more than 140 million RMB by the end of January on a project specifically to provide additional support on purchasing and distributing medical resources to Wuhan and the surrounding cities.[74]

Clearly, the private sector has not only increased its contribution to China's economy, but also its role in society. While the public sector still plays a critical role in terms of resource allocation, and during the crisis received a large amount of centrally allocated funds, even SOEs were encouraged by the government to support the private sector. Meanwhile, a powerful new group of social institutions have contributed significantly toward the response to COVID-19, and are expected to play an elevated role in Chinese society going forward.

As the world turns its attention from containing the COVID-19 outbreak to planning the reopening of society, and the restarting of economies, we hope the five accelerating trends outlined here regarding how the response to COVID-19 has affected China prove helpful references to decision makers in the corporate and public sectors around the world.

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[70] *Bill & Melinda Gates Foundation Commits $10 Million to Global Response to 2019-nCOV,* Bill & Melinda Gates Foundation, January 26, 2020, https://www.gatesfoundation.org/Media-Center/Press-Releases/2020/01/Gates-Foundation-Commits-10-Million-to-Global-Response-to-2019-nCOV.

[71] *Vanke Foundation donated 100 million to Wuhan*, Sina, January 25, 2020, http://finance.sina.com.cn/stock/relnews/cn/2020-01-25/doc-iihnzhha4569082.shtml.

[72] Evelyn Cheng, *Coronavirus outbreak gives public health in China the push it needs*, CNBC, April 9, 2020, https://www.cnbc.com/2020/04/10/coronavirus-outbreak-gives-public-health-in-china-the-push-it-needs.html.

[73] National Committee on US China Relations, *Coronavirus Social Impact: NGOs Operating and Evolving through COVID-19*, https://www.ncuscr.org/media/podcast/coronavirus-impact-knup

[74] Holly Snape, *China Alters Civil Society Rules, Allowing More Groups to Respond to Coronavirus*, The China NGO Project, March 5, 2020, https://www.chinafile.com/ngo/analysis/china-alters-civil-society-rules-allowing-more-groups-respond-coronavirus

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The authors would like to thank the following colleagues for their contributions to the research and writing of this article: Spencer Liu, Rainy Wang, and Glenn Leibowitz.

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How COVID-19 has changed Chinese consumption

Despite all the post-pandemic uncertainty, one thing is clear: China will continue to be the engine that powers global consumption growth.

Daniel Zipser, Felix Poh, Johnny Ho, Kay Tu

The COVID-19 pandemic is continuing apace globally, posing the greatest humanitarian challenge of our age as governments scramble to address devastating health and economic impacts. The challenge for policymakers is to strike the right balance between containing viral transmission and restarting locked-down economies to secure employment.

Retail and consumer packaged goods (CPG) companies also have an essential role to play, not just in helping us coexist with the virus, but also as sources of employment and social stability. From a global perspective, their outlook is deeply uncertain. As of September, many countries are battling a second or third wave of infections, even as a failure to arrest the first wave in the Americas means the region now accounts for 55 percent of new daily cases.

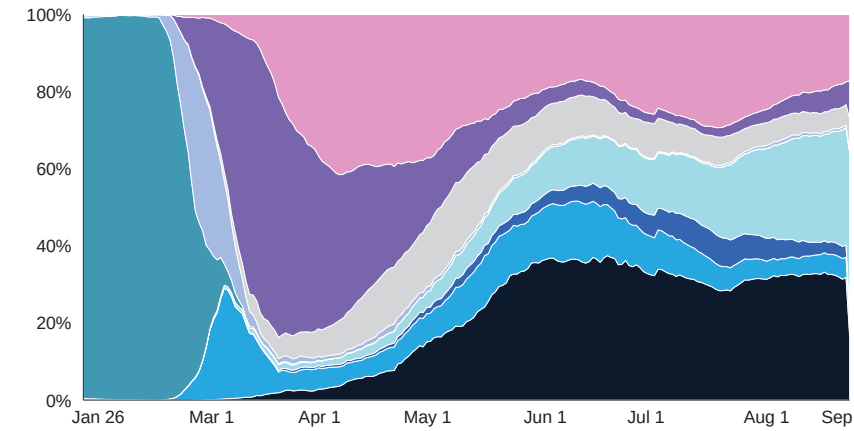
By contrast, China is optimistic. Having worked hard to contain the original outbreak of the novel coronavirus in Wuhan, the government has effectively controlled virus transmission. Since mid-March, a combination of travel restrictions, testing, and digital health and tracking initiatives, has kept most of China virus-free. China consequently hosted just 0.01 percent of new global COVID-19 cases as of Sep 22nd (Exhibit 1). Local health authorities have rapidly traced and suppressed new outbreaks, including a high-profile outbreak in Beijing in June, helping reassure anxious consumers.

Exhibit 1

Shifts in percentage of daily new COVID-19 cases worldwide

by country/region

The incidence of new cases is shifting from countries in Europe, to North America, Latin America, and South Asia



	Jan 26	Mar 1	Apr 1	May 1	Jun 1	Jul 1	Aug 1	Sep 22
Total new cases on day		**1,752**	**76,833**	**87,399**	**125,540**	**187,614**	**297,179**	**222,256**

As of Sep 22, 2020

US[1] + Canada: **17.22%**	Oceania + North Asia[3] : **0.18%**	Africa : **1.43%**
EU + UK: **9.66%**	China : **0.01%**	Middle East : **5.02%**
Other European[2]: **8.48%**	Other Asian[4] : **41.41%**	Latin America + Caribbean[5] : **16.59%**

[1]Includes Puerto Rico and US Virgin Islands
[2]All remaining European countries, including Russia
[3]Includes Japan, Singapore, and South Korea
[4]All remaining Asian countries, not including Russia
[5]Includes European territories in the Caribbean
[6]Data points shown as 7-day moving average to account for reporting differences (e.g., reporting only once per week)

Source: WHO, JHU

Chinese consumers: Confident, optimistic, and ready to spend

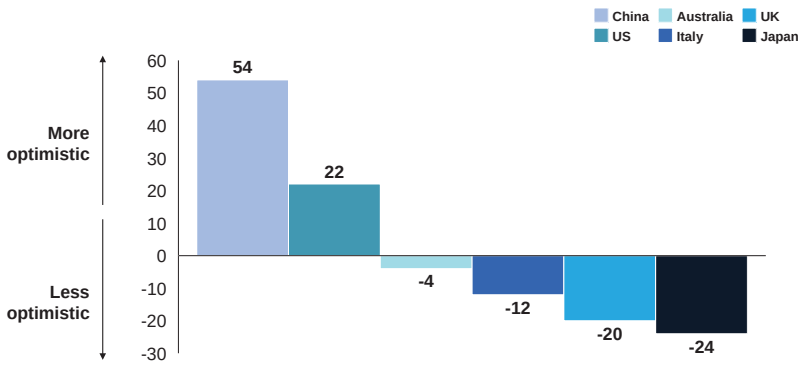
The effectiveness of China's public health response has inspired an unparalleled rebound in consumer confidence; McKinsey consumer sentiment surveys show that net optimism over the recovery of the economy in China has hovered around 50 percent, compared with about 22 percent in US, and in stark contrast to the pessimism that pervades Europe, Australia, and Japan (Exhibit 2). A notable outlier is the US, which has a relative optimism that is likely driven by culture and future expectations.

From a global perspective, Chinese consumers are most confident they will be able to resume their daily routines after the pandemic, with 60 percent indicating they expect to do so within two to three months. In comparison, a mere 13 percent of consumers in Germany, and 5 percent in Japan, expect

Exhibit 2

Optimism about own country's economic recovery after COVID-19[1]

Net optimism %[2] , Sep 28th



[1]Q: How is your overall confidence level on economic conditions after the COVID-19 situation? Rated from 1 "very optimistic" to 6 "very pessimistic."
[2]Net optimism is calculated by subtracting the percent of respondents who answered 5 "pessimistic" and 6 "very pessimistic" from the percent of respondents who answered 1 "very optimistic" and 2 "optimistic."

Source: McKinsey COVID-19 Consumer Pulse surveys; conducted globally between Sep 4 and Sep 28, 2020

their lives to return to normal within the same timeframe (Exhibit 3). Four out of five people in the rest of the world believe it will take at least four months for normality to be restored.

Exhibit 3

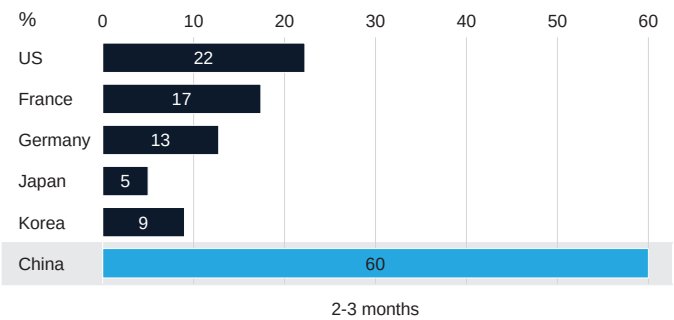
Respondents' belief about the time it will take to return to normal

% of respondents

How long will it take routines impacted by COVID-19 to return to normal[1]

60%

For China



[1]Q: How long do you believe you need to adjust your routines, given the current coronavirus (COVID-19) situation, before things return back to normal in your country (e.g., government lifts restrictions on events/travel)?
[2]Q: How long do you believe your personal/household finances will be impacted by the coronavirus (COVID-19) situation?
Source: McKinsey & Company; COVID-19 Consumer Pulse surveys; conducted globally between June 15 and June 21, 2020; source of data for South Africa and Brazil was from McKinsey & Company; COVID-19 Consumer Pulse surveys, conducted between May 15 and May 25, 2020

Channel hopping: China's advanced digital infrastructure enabled a rapid shift to online

Prior to COVID-19, China was already among the world's most digital nations, accounting for close to half of global ecommerce sales. When the virus struck, lockdown measures accelerated an ongoing trend of consumers shifting away from traditional retail towards online channels. This opened online ordering to new customer segments, with people over 30 years old increasing their share of ecommerce spend by 11 percentage points between January and February, according to QuestMobile data.

China's sophisticated digital infrastructure ensured that online initiatives launched in response to COVID-19 offered quality service, not least in fulfilling orders in hours or days rather than the weeks it might take in less developed economies. Companies already engaged in digital transformations were able to accelerate momentum, and successfully cater for increased demand for online shopping and other digital services.

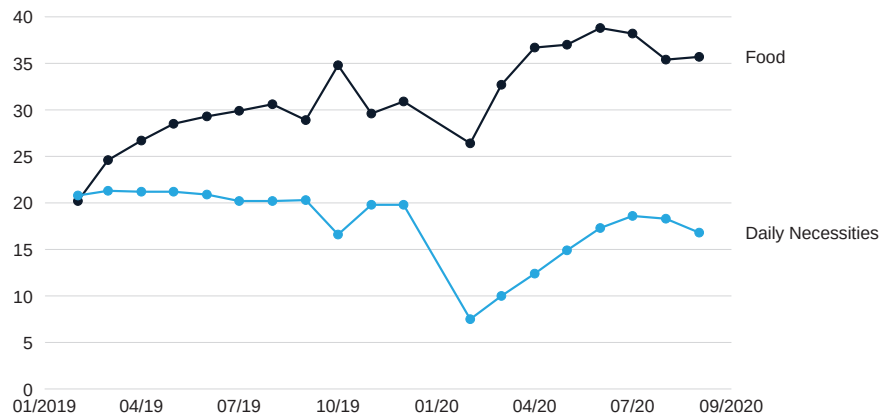
Usage of delivery apps surged during the crisis, driving higher online sales of food and daily necessities. According to our COVID-19: China grocery consumer survey, online penetration of grocery sales in China rose 15-20 percentage points during the peak of the crisis (Exhibit 4). We expect at least 6 percent of that increase to stick; more than 55 percent of Chinese consumers told us they are likely to permanently buy more groceries online. Leading online-to-offline grocery retailers such as Freshippo, RT-Mart, and JD Supermarket, as well as Xingsheng Selected, a leader in community group purchasing, all capitalized on early strategic decisions to focus on omnichannel fulfillment and digitization. This meant these players already had the necessary supply chain and digital app infrastructure at the onset of the crisis, allowing them to smoothly accelerate the adoption of ecommerce.

Beauty brands that had established social commerce infrastructure in place were also able to expand sales during the crisis by quickly shifting resources to online channels. For example, Perfect Diary, a fast-growing local beauty brand, intensified customer engagement during COVID-19 on its existing WeChat-based social channels, driving higher sales and lifting the brand's valuation to $2 billion during an April fundraising round, double that achieved last September. Beauty brands like Estée Lauder and L'Oréal also leveraged their social commerce infrastructure (for example, the enterprise version of WeChat) to activate and empower their beauty consultants to better reach and engage consumers.

Exhibit 4

Online retail goods sales growth in China by category

Monthly, year-on-year, year-to-date, percent



Source: CEIC; McKinsey analysis

Homing in: Rethinking at-home occasions

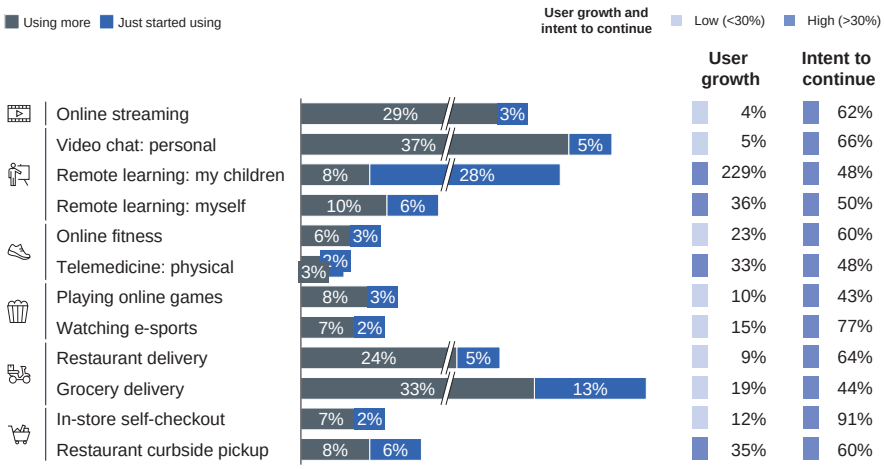
Aside from online shopping, Chinese consumers have embraced new digital activities that do not require in-person interactions, leading to a rise in at-home occasions that poses a significant new test for retailers and CPG companies. For example, one in four people tried remote learning for their children for the first time, while services like online streaming and video chat experienced substantial increases in usage. These changes are set to endure; a majority of consumers told us they intend to keep watching e-sports and online fitness programs. Remote learning for adults looks like another trend that might be here to stay (Exhibit 5).

In keeping with these trends, both retailers and CPG companies need to rethink their approach to marketing and portfolio management. For example, alcohol consumption shifted almost exclusively to at-home at the beginning of the year. While restaurants and bars have strongly recovered, we anticipate at-home occasions to remain more relevant than pre-crisis (Exhibit 6). Beverage makers

Exhibit 5

Pick-up of digital & low-touch activities during and after COVID-19[1]

% of respondents who replied using more or just started using



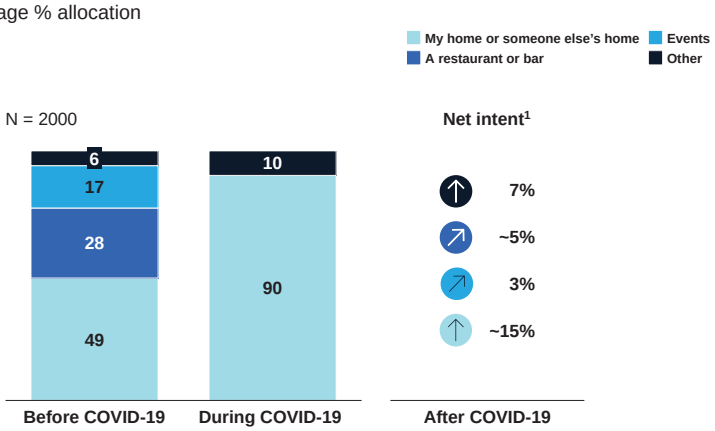
[1]Q: Have you used or done any of the following since the COVID-19 situation started? If yes, Q: Which best describes when you have done or used each of these items? Possible answers: "just started using since COVID-19 started"; "using more since COVID-19 started"; "using about the same since COVID-19 started"; "using less since COVID-19 started."

Source: McKinsey COVID-19 China Consumer Pulse Survey

Exhibit 6

Alcohol consumption occasion shift during and after COVID-19

Weighted average % allocation



[1]Once the coronavirus (COVID-19) situation has subsided, how do you think your alcohol consumption occasions at the following places / occasions / people will change compared to your consumption prior to COVID-19?

Source: McKinsey China alcohol consumer survey

should work to improve their understanding of why people drink at home, and adjust their brand and pack offerings accordingly.

Budweiser adapted by launching new ecommerce and omnichannel at-home consumer experiences, including DJ livestreams and e-gaming events that provided a platform for customized marketing, and home delivery promotions. Tsingtao rolled out a no-contact delivery service, leveraging its vast distribution network in 300-plus cities. Consumers ordered via phone or WeChat, and collected their beverages at a nearby pick-up point.

Taking advantage of an increase in demand for in-home wellness and fitness services, leading Chinese workout app KEEP launched hundreds of livestreams featuring key opinion consumers—everyday consumers whose value lies in perceptions of reliability, trustworthiness, and independence. Streams teaching yoga, collaborations with brands to promote in-home fitness tools, and question and answer sessions on fitness topics such as post-partum body recovery attracted 56 million views within a week, more than tripling KEEP's daily active users compared with pre-crisis levels. Fitness coaches curated WeChat groups and managed daily training sessions, offering tips and guidance to attract new traffic and maintain user engagement during lockdown.

Healthy choices: Building trust amid shifting consumption patterns

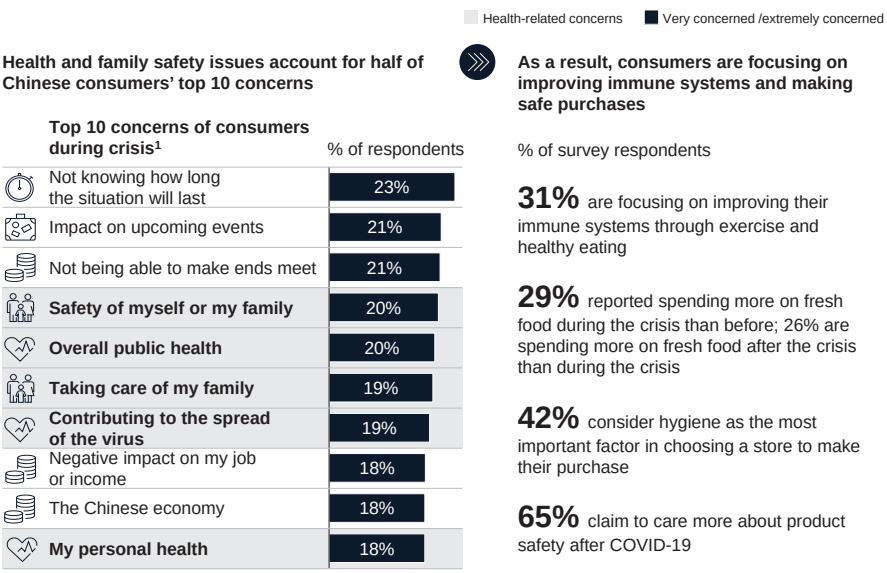
Chinese consumers have become more health and quality conscious as a result of COVID-19, and are trying to improve their overall health and ability to fight off infections. According to our research, the safety of family, overall public health, concern over spreading COVID-19 and personal health are among Chinese consumers' top ten concerns. These anxieties underpin significant changes in consumer behavior: two-thirds of our respondents claim to care more about product safety than they did before the pandemic, for example. Almost a third of consumers are also spending more on fresh foods, in keeping with a heightened focus on healthy living (Exhibit 7).

Shoppers are also becoming more prudent spenders; one-third said they are more mindful of where and how much they spend as a result of COVID-19. According to our surveys, Chinese consumers lead the world in researching brand and product choices before buying, with 45 percent telling us they have stepped up this behavior since the outbreak of COVID-19, compared with only 11 percent for France and Germany, and 12 percent for Japan.

As consumers rethink their purchase options, we are seeing sweeping shifts in brand choice that illustrate the make or break nature of China's current retail environment. One-third of consumers told us they have switched to new brands during the pandemic, driven by factors such as availability, convenience, price

Exhibit 7

Chinese consumers' concerns about the COVID-19 situation


Health-related concerns
Very concerned /extremely concerned
Health and family safety issues account for half of Chinese consumers' top 10 concerns
Top 10 concerns of consumers during crisis[1]
% of respondents
Not knowing how long the situation will last
23%
Impact on upcoming events
21%
Not being able to make ends meet
21%
Safety of myself or my family
20%
Overall public health
20%
Taking care of my family
19%
Contributing to the spread of the virus
19%
Negative impact on my job or income
18%
The Chinese economy
18%
My personal health
18%
As a result, consumers are focusing on improving immune systems and making safe purchases
% of survey respondents
31% are focusing on improving their immune systems through exercise and healthy eating
29% reported spending more on fresh food during the crisis than before; 26% are spending more on fresh food after the crisis than during the crisis
42% consider hygiene as the most important factor in choosing a store to make their purchase
65% claim to care more about product safety after COVID-19

[1]Q: What concerns you most about the COVID-19 situation? Possible answers: "not a concern"; "minimally concerned"; "somewhat concerned"; "very concerned"; "extremely concerned."

Source: McKinsey COVID-19 China Consumer Pulse Survey in April (including Hubei province); 2020 Edelman Trust Barometer Special Report: Brands and the Coronavirus

discounts, and product promotions, as well as perceptions of safety. Trust is vital as consumers navigate an uncertain information environment, with 89 percent telling us they are turning to brands that they trust. Three-quarters of Chinese consumers also stated they have convinced other people to stop using brands they felt were not acting appropriately during the pandemic. On the other hand, 82 percent of consumers said they recently started using a new brand because of the innovative or compassionate way the brand responded to the crisis.

Rising to the challenge

While much of the world debates when or if daily life will return to normal after COVID-19, Chinese consumers are already moving on, propelling a strong rebound in domestic consumption. Though the virus is under control for now, the consumer environment has fundamentally shifted, challenging brands and retailers to reconsider their operating models across product mix, pricing, channel strategy, and marketing. Consumer companies should consider adopting the following actions:

Innovate product offerings and services: Trends such as the shift to at-home occasions and rising health consciousness among Chinese consumers demand a coordinated response, beginning with a thorough analysis of changes in

consumer behavior. Segment trends by category and consumer archetype, focusing on pre-, during and post-COVID-19 differences, before revamping product mix and service delivery accordingly.

Accelerate online and omnichannel: Brands should view online as a must-do and start setting digital key performance indicators, while considering the role and interaction of different online and offline channels, including direct-to-consumer, social commerce, ecommerce marketplaces, and physical channels. Clarify whether each channel's role is for brand-building, consumer engagement, or to drive sales, and allocate investment accordingly.

Build a resilient and balanced supply chain: Start with having transparency of the supply chain that goes beyond the four walls of the company and into the layers of the supply network. Build end-to-end omnichannel capabilities and mitigate risks and uncertainties through revised sourcing and product design strategies.

Improve organizational agility: Facing increased uncertainty in the post-pandemic era, companies should embrace a nimble mindset and build agility into their organizations. Astute executives can prepare for disruptions by war-gaming scenarios that test the resilience of existing operating models—for instance, revised demand projections for lower-tier cities and rural areas creating the need for change in current distribution models—and set up cross-functional teams to address any gaps that arise from this pressure-testing.

Institutionalize M&A: This may be an opportune time to pick up valuable assets at a fair price, or to 'acquihire' by buying companies for their talent and capabilities.

Clarify purpose: Companies should take the opportunity to clarify and communicate a clear company vision and purpose both internally and externally, and in doing so, deepen trust with employees, business partners, customers and consumers.

Despite all the post-pandemic uncertainty, one thing is clear: China will continue to be the engine that powers global consumption growth. This was true prior to COVID-19, and is arguably even more relevant as the world looks to a future beyond the virus.

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The authors wish to thank Nicola Jiang, Cherie Zhang, Pauline Chen, Hao Xu and Xin Huang for their contributions to this article.

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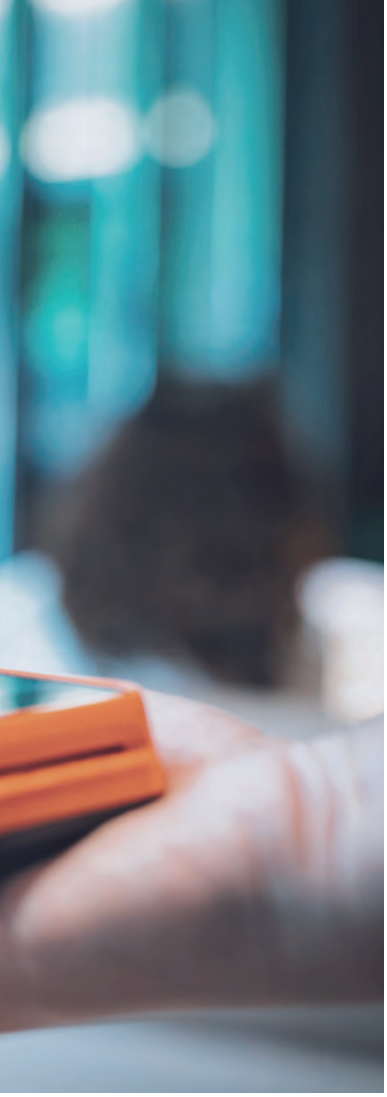
How Chinese consumers are changing shopping habits in response to COVID-19

An analysis of point of sale data for over 100 million shoppers shows four key trends that are likely to persist post-crisis.

Chenan Xia, Daniel Zipser, Dymfke Kuijpers, Lavonda Li, Sha Sha, Xin Huang



China is ahead of the curve in its recovery from the recent COVID-19 outbreak, with many provinces slowly returning to normal levels of activity. Factories are restarting production and consumers are beginning to spend again. However, the crisis has had a dramatic and lingering impact on the nation's shopping habits, with implications for brands in China and globally.

McKinsey worked with MIYA, a leading mobile payment solutions provider, to set up a sample tracking analysis engine based on MIYA's 130,000 merchants, 500 million+ shoppers and 5 billion+ transactions. The sample tracking analyzed point-of-sale (POS) data from 31,000 stores, covering 150+ cities, including Wuhan and Hubei, and 100 million+ shoppers. The data, which has been updated to May 10, reveals four key shifts that are persisting even as the peak impact of the virus abates.

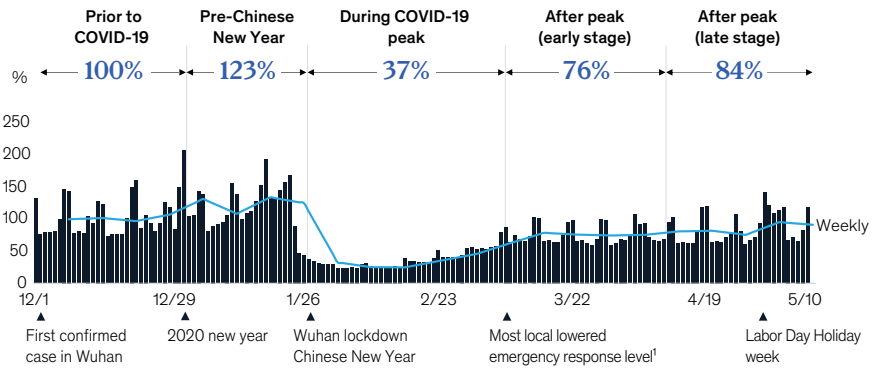
1. Offline shopping is slowly recovering, but discretionary spend, night-time shopping, and epicenter spend are lagging

Offline consumption is slowly recovering, after falling to around 37 percent of normal levels during the peak period of the outbreak. Many local authorities loosened restrictions in the first week of March, giving shops an opportunity to welcome customers who had been isolated in their homes for as long as six weeks. By May 10, offline consumption had picked up to around 84 percent of pre-crisis levels. And in the two weeks leading up to May 10, consumption rose by 105 percent over pre-crisis levels, driven by the Labor Day Holiday (Exhibit 1).

Exhibit 1

China offline consumption is still impacted after the outbreak

China offline avg. consumption by day and week, 100% = avg. daily consumption in Dec 2019



[1]On March 8th, 21 provinces of China announced to lower the epidemic response level, which involves over 70% population of the country.
Source: MIYA payment data engine, McKinsey China retail POS analysis 20191201–20200510

Despite the partial rebound, there were significant variations, amid continuing pressure on discretionary categories. Supermarkets, convenience stores, and drugstores saw a spike in activity during the crisis, as consumers stocked up on essentials and cooked at home. However, after the peak there was a divergence (Exhibit 2). Supermarket volumes fell, while convenience stores and drugstores continued to see positive momentum, driven by demand for medicines and a desire among many people to shop near their homes. Discretionary categories, such as food service outlets, apparel stores, and department stores were hit hard during the crisis and their recovery has been slow.

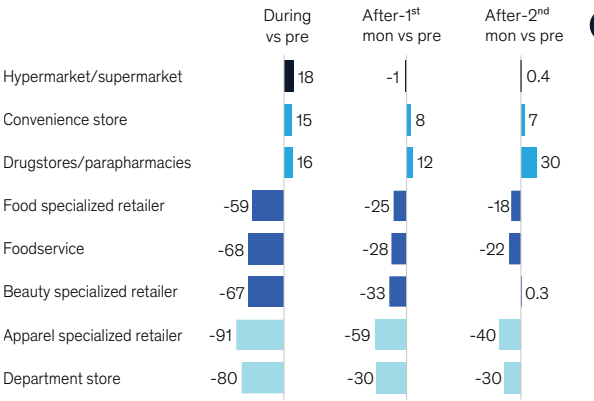
A notable trend across categories during the outbreak was increased basket sizes in non-discretionary categories, reflecting consumer aversion to shopping trips and willingness to spend more per visit to reduce travel frequency. Convenience store basket sizes rose 124 percent during the crisis, and remained 22 percent higher as the crisis abated. Discretionary categories, such as department and apparel stores, on the other hand, saw smaller basket sizes (Exhibit 3). Department store basket sizes were 54 percent smaller during the crisis, and have recovered only slightly in March and April, to a level that is around 21 percent smaller than before the crisis. Again, this may be a reflection of people's reluctance to spend too long in crowded environments.

Absolute traffic levels fell dramatically in all categories except drug stores during the crisis (31 percent lower for supermarkets and 88 percent lower for apparel outlets), and continued to be lighter than normal after the peak. Some 95 percent of apparel stores have reopened, but footfall in discretionary categories is still 20 percent below pre-COVID-19 levels. In non-discretionary categories it is around 20-30 percent lower.

Exhibit 2

Some channels have fared better than others

Daily Consumption, 100% = avg. in Dec 2019

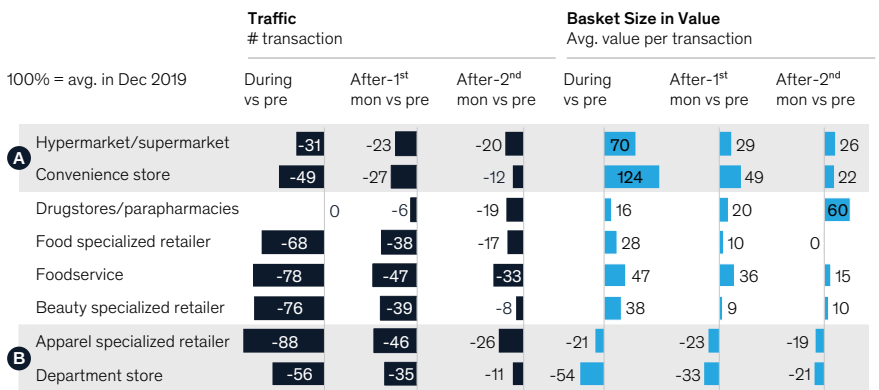

During vs pre
After-1st mon vs pre
After-2nd mon vs pre
Hypermarket/supermarket 18 -1 0.4
Convenience store 15 8 7
Drugstores/parapharmacies 16 12 30
Food specialized retailer -59 -25 -18
Foodservice -68 -28 -22
Beauty specialized retailer -67 -33 0.3
Apparel specialized retailer -91 -59 -40
Department store -80 -30 -30

- **Hyper/super market** shows spike during crisis along with CVS, due to more people cook at home, yet no sign of a lasting uplift as it comes back to normal level when the recovery starts
- **CVS and drug stores** are still above their historic levels due to long lasting impact of COVID-19 (e.g., compared to SARS)
- **Food stores and restaurants are still not fully recovered** due to long lasting impact of COVID-19
- **Apparel and department stores were hit hard and recover slowly.** Offline spending on apparel is devastating with 90% decline during virus peak

Source: MIYA payment data engine, McKinsey China retail POS analysis 20191201 – 20200510

Exhibit 3

Traffic fell and baskets expanded


Traffic
transaction
Basket Size in Value
Avg. value per transaction
100% = avg. in Dec 2019
During vs pre
After-1st mon vs pre
After-2nd mon vs pre
During vs pre
After-1st mon vs pre
After-2nd mon vs pre
A
Hypermarket/supermarket -31 -23 -20 70 29 26
Convenience store -49 -27 -12 124 49 22
Drugstores/parapharmacies 0 -6 -19 16 20 60
Food specialized retailer -68 -38 -17 28 10 0
Foodservice -78 -47 -33 47 36 15
Beauty specialized retailer -76 -39 -8 38 9 10
B
Apparel specialized retailer -88 -46 -26 -21 -23 -19
Department store -56 -35 -11 -54 -33 -21

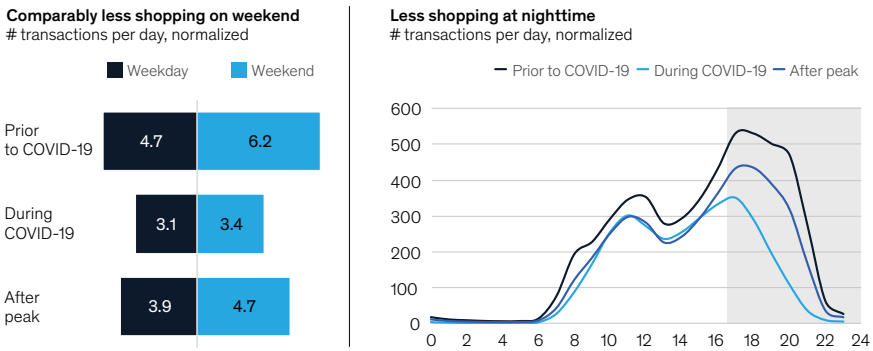
A Consumers **drastically reduce the number of shopping trips** but **increase their baskets significantly,** resulting in sales growth in supermarket and CVS

B While **~95% of apparel stores and department store have re-opened, traffic still ~20% below** pre-COVID-19 levels

Source: MIYA payment data engine, McKinsey China retail POS analysis 20191201–20200510

Exhibit 4

Weekend and evening shopping fell significantly and have not fully recovered



Source: MIYA payment data engine, McKinsey China retail POS analysis 20191201–20200510

The impact of the crisis on shopping habits was revealed through the times of day at which people ventured out (Exhibit 4). In normal times, weekend and evenings are peak shopping times in China—weekend traffic is generally 30 percent higher than weekday traffic and evening traffic is 50 percent higher than day traffic. The traffic curves were much flatter during the height of the outbreak, with weekend traffic just 10 percent higher than weekday traffic and evening peak hours about 15 percent higher than daytime peaks. Again, the pace of recovery has been slow, with shopping patterns continuing to echo those at the height of the crisis. Daily transaction volumes have recovered by around 50 percent from the trough.

Tier 1 cities such as Beijing, Shanghai, and Shenzhen are the busiest in China, and these normally crowded environments have been slower to recover than lower-tier cities. Most channels have continued to see spending 20 percent lower than that before the crisis. Cities at the epicenter of the outbreak (in Hubei province) have also seen sluggish recoveries. There has, however, been some variation across channels (Exhibit 5).

2. Channel shift to online, offline convenience, and drugstores

A trend that emerged from the crisis is the accelerating growth of the online channel, which benefited from the lockdown, store closures, and the continued reluctance of consumers to engage in-person with sales and service staff (Exhibit 6). In the grocery category, there was a spike in online shopping during the peak, with consumers spending more time and money online. Some

Exhibit 5

The epicenter has recovered more slowly than elsewhere

Based on observation of selected cities

After vs Pre avg. daily consumption in selected cities
0% = baseline, avg. in Dec 2019

-100% 0% 100%

	Wuhan	Hubei—other cities	Tier 1 cities: BJ, SH, SZ, CQ	Provincial capital cities[1]	Other cities[1]
Hypermarket/supermarket	-4%	4%	-7%	7%	1%
CVS	-24%	-6%	21%	12%	17%
Drugstores/para pharmacies	N/A	N/A	-38%	56%	94%
Food specialized retailer	-29%	-13%	-29%	-2%	-4%
Foodservice	N/A	-15%	-20%	7%	-33%
Beauty specialized retailer	-57%	-11%	-16%	-2%	1%
Apparel	N/A	-40%	-43%	-45%	-35%
Department store	N/A	-42%	-34%	-13%	-27%

Epicenter recovers much slower than other cities due to long impact of COVID-19

Tier-1 cities are relatively slow on recovery compared with other cities, as re-open rate is already 90+%

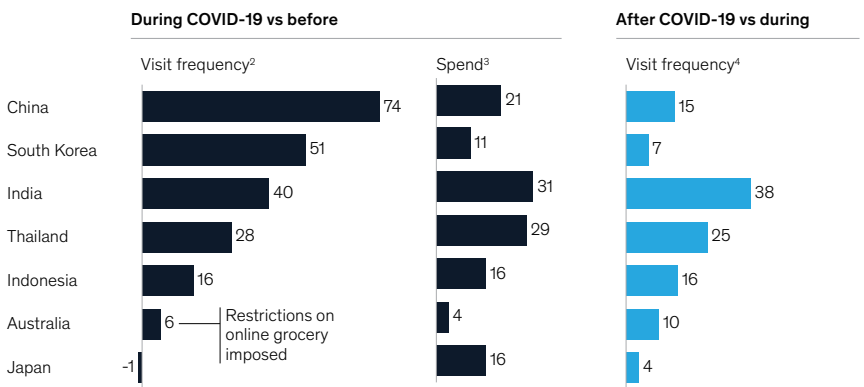
Source: MIYA payment data engine, McKinsey China retail POS analysis 20191201–20200510

74 percent of consumers bought additional groceries online at the peak and 21 percent spent more. Chinese consumers were ahead of consumers in other countries in respect of frequency of online shopping, including South Korea (51 percent increased frequency) and India (40 percent). In March, online activity in China has moderated, but visits are still running at 15 percent above pre-crisis levels.

Exhibit 6

An acceleration in online grocery shopping

Online grocery channel net reported behavior during COVID-19 vs before; net intent for after COVID-19 vs during (now)[1]

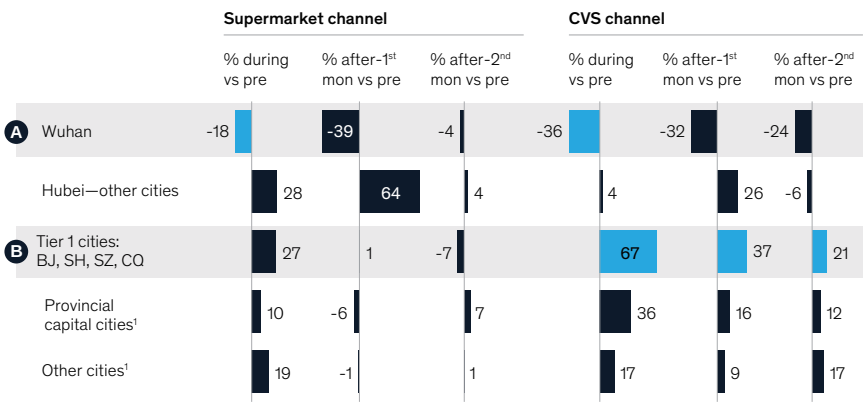


[1]Net behavior is calculated by subtracting the % of shoppers in the channel stating they have decreased visit frequency or spending in the channel from the % stating they increased frequency or spending.
[2]Q: Among the below grocery shopping channels, which ones do you visit more/less frequently during the COVID-19 outbreak compared to before?
[3]Q: Which store types have you increased/ decreased your spending per month during the COVID-19 outbreak compared to before?
[4]Q: Within the below store types, which ones do you think you will visit more / less frequently after the COVID-19 outbreak stabilizes?
Source: COVID-19 mobile survey, 3/21-3/25/2020 N = 5,013, sampled and balanced to match general population (except India, with higher focus on consuming class)

Exhibit 7

Consumers in tier 1 cities spent more in convenience stores during and after the crisis

Based on observation of selected cities[1]
Avg. daily consumption in supermarkets vs CVS by city[1], %



A Epic center recovery is heavily impacted by store opening schedule:

- Wuhan supermarket and CVS spending went up at the beginning of the outbreak and eventually to a reduction due to lock-down duration and supply issues
- Also the substantial drop in supermarket and CVS after peak might suggest a shift to online

B Consumer in tier 1 city shows stronger preference on CVS during and after peak

[1]Cover selected cities: Beijing, Shanghai, Chongqing, Guangdong, Zhejiang, Jiangsu, Shanxi, Shandong, Jilin, Fujian, Sichuan, Jiangxi and Hubei.
Source: MIYA payment engine, McKinsey analysis

Another emerging dynamic is that convenience stores have performed well in the wake of the outbreak (as they did at the peak), with tier 1 cities seeing the biggest uplifts (Exhibit 7). CVS daily consumption in tier 1 cities has run at around 21 percent above pre-crisis levels (as at December 2019). Again, this is likely the result of continuing caution in respect of travelling and mixing in large groups.

3. Health and fitness is here to stay

COVID-19 has emphasized the importance of staying fit and healthy, and changing attitudes are reflected in shopping behaviors that have persisted in March and April. Demand for dairy, vegetables, and eggs was 25-50 percent higher during the initial recovery phase than it was before the crisis. Supermarket and convenience store data shows that, aside from fresh food, popular items during and after the peak of the crisis included grains, ready-to-cook meals, packaged food, and snacks.

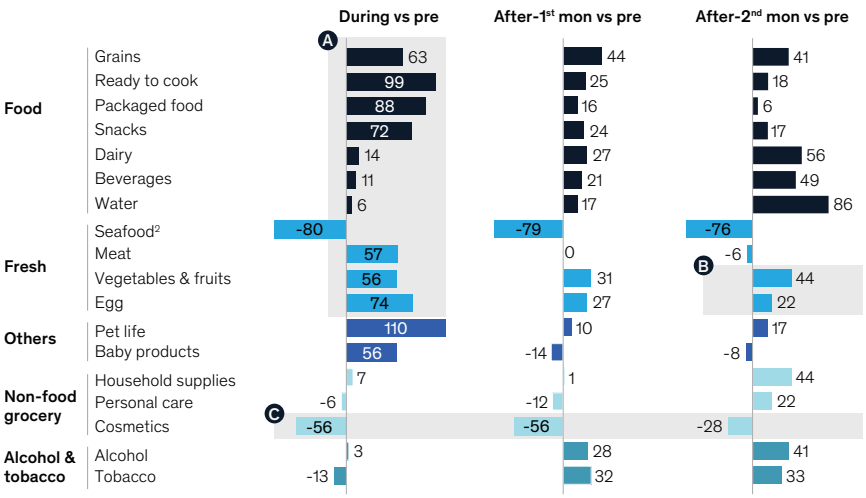
As people began to spend less time at home, demand for these has softened of late but is still running above pre-crisis levels. There was a reduction in demand for personal care products and cosmetics in January and February, and these categories are only recovering slowly (Exhibit 8).

Exhibit 8

People stocked up on essentials and bought more fresh food

Based on grocery basket analysis, data from supermarket and convenience stores

Daily consumption in value[1], 100%=avg. Dec 2019



Consumption shift in short term with increase on necessity; non-essential consumption picks up recovery speed later

A **Food first during crisis:** people stock up 60-80% more food and fresh, to prepare for staying at home during lock down, but not substantial

B **Healthy trends** in dairy, vegetables, fruit and egg as these categories went up during the outbreak and still keep 30-40% higher after the peak

C **Cosmetics has experienced a shift to online during and after the peak**

[1] Based on grocery basket analysis, data from supermarket and CVS.
[2] Due to the limitation of fresh seafood supply—from fishing to delivery—the seafood are still over 70% down vs before.
Source: MIYA payment data engine, McKinsey China retail POS analysis 20191201–20200510

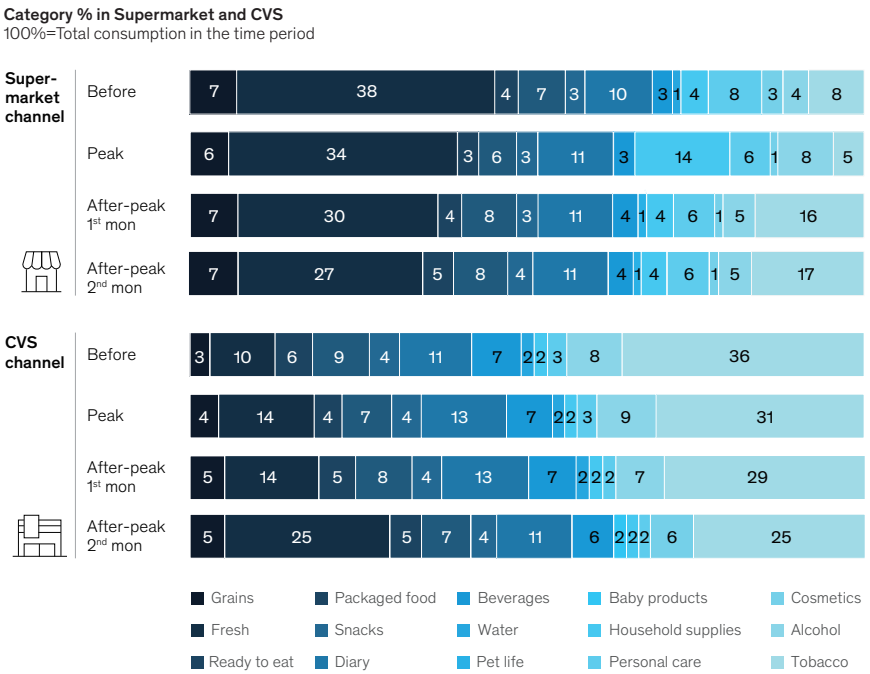
As shoppers have gravitated toward local stores, they have expanded the range of items they buy, adding more grains and fresh foods to their baskets (Exhibit 9). If the trend continues, suppliers in these categories may need to plan for a less centralized distribution model, in which individual CVS stores are likely to offer a variety of products while carrying fewer brands in any single product category.

4. Shock to loyalty offline, partly offset by online engagement

Given the physical constraints of the crisis, Chinese customers have been more willing to try new stores and new brands. After the peak, around 14 percent do not plan to revert to their pre-crisis store choices and about 6 percent do not plan to return to their previous brands (Exhibits 10 and 11). To engage with these dynamics, hard-hit categories such as apparel have ramped up their digital activities. One premium fashion retailer, for example, invested in online

Exhibit 9

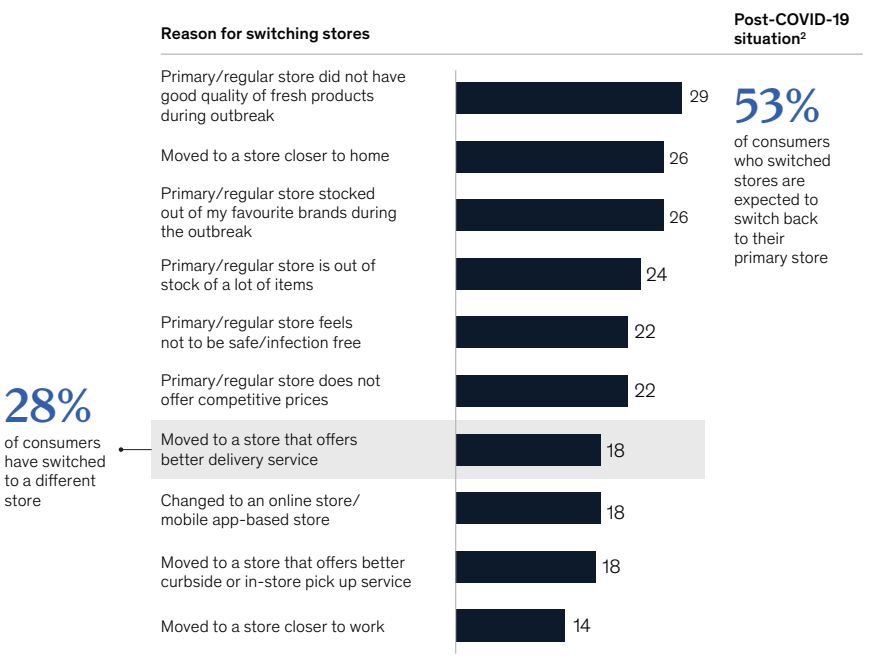
Increased demand for grains and fresh food at convenience stores


Category % in Supermarket and CVS
100%=Total consumption in the time period
Super-market channel
Before
7 38 4 7 3 10 3 1 4 8 3 4 8
Peak
6 34 3 6 3 11 3 14 6 1 8 5
After-peak 1st mon
7 30 4 8 3 11 4 1 4 6 1 5 16
After-peak 2nd mon
7 27 5 8 4 11 4 1 4 6 1 5 17
CVS channel
Before
3 10 6 9 4 11 7 2 2 3 8 36
Peak
4 14 4 7 4 13 7 2 2 3 9 31
After-peak 1st mon
5 14 5 8 4 13 7 2 2 2 7 29
After-peak 2nd mon
5 25 5 7 4 11 6 2 2 2 6 25
Grains
Packaged food
Beverages
Baby products
Cosmetics
Fresh
Snacks
Water
Household supplies
Alcohol
Ready to eat
Diary
Pet life
Personal care
Tobacco

Source: MIYA payment data engine, McKinsey China retail POS analysis 20191201–20200510

Exhibit 10

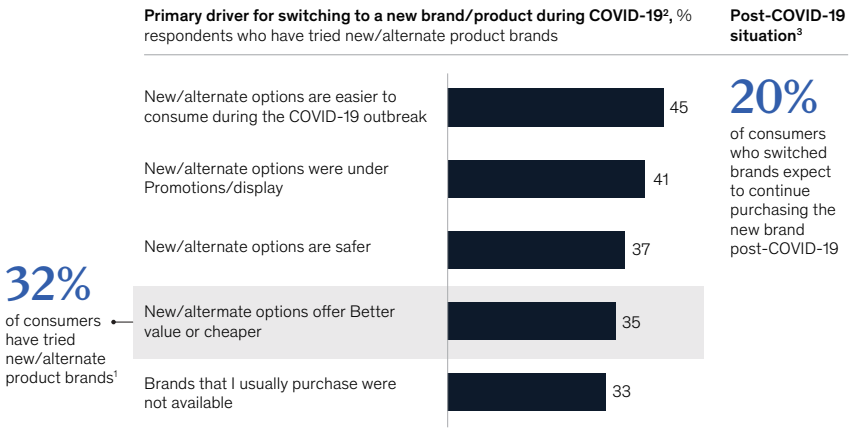
More than a quarter of shoppers have shifted away from their primary stores, of which 47% do not intend to switch back


Reason for switching stores
Post-COVID-19 situation[2]
Primary/regular store did not have good quality of fresh products during outbreak 29
Moved to a store closer to home 26
Primary/regular store stocked out of my favourite brands during the outbreak 26
Primary/regular store is out of stock of a lot of items 24
Primary/regular store feels not to be safe/infection free 22
Primary/regular store does not offer competitive prices 22
Moved to a store that offers better delivery service 18
Changed to an online store/ mobile app-based store 18
Moved to a store that offers better curbside or in-store pick up service 18
Moved to a store closer to work 14
53%
of consumers who switched stores are expected to switch back to their primary store
28%
of consumers have switched to a different store

Source: McKinsey & Company COVID-19 mobile survey 3/21-3/23/2020 N = 611 Sampled and balanced to match China's general population 18-65 years-old

Exhibit 11

A third have switched brands based on convenience and promo/display, of which 20% intend to stick to their new choice


Primary driver for switching to a new brand/product during COVID-19[2], % respondents who have tried new/alternate product brands
Post-COVID-19 situation[3]
New/alternate options are easier to consume during the COVID-19 outbreak
45
New/alternate options were under Promotions/display
41
New/alternate options are safer
37
New/altermate options offer Better value or cheaper
35
Brands that I usually purchase were not available
33
20%
of consumers who switched brands expect to continue purchasing the new brand post-COVID-19
32%
of consumers have tried new/alternate product brands[1]

[1] Q: Have you tried new/alternate product brands during the current COVID-19 outbreak that you do not usually purchase?
[2] Q: Why did you switch from the brands you usually purchase to new/ alternate options? (N = 196, Percent of responses from consumers who have tried new new/alternate product brands)
[3] Q: After COVID-19, do you in general plan to switch back to the product brands you usually purchased before? (N = 196, Percent of responses from consumers who have tried new new/alternate product brands)
Source: McKinsey & Company COVID-19 mobile survey 3/21-3/23/2020 N = 611 Sampled and balanced to match China's general population 18-65 years-old

channels such as Tmall, e-commerce platform, and social media. Its offline sales fell by about 50 percent in March, but its online sales grew by 60 percent. A large grocery retailer saw a 300 percent spike in demand for its home delivery service and has launched a major effort to triple its online business in 2020.

In aggregate, the data shows that COVID-19 has had a profound and persistent impact on the nation's shopping habits. The implications for brands in China, and other countries that may follow China's path to recovery, can be summarized under four strategic pillars:

1. **Continue to protect customers and employees.** COVID-19 is likely to have a lingering effect on consumer attitudes and sentiment. Assuming the virus is not eliminated in the near future, companies should redesign their protocols and operating models to reflect the new reality. This would include, for example, actions to be taken if a customer or an employee caught the virus.
2. **Drive triple digital transformation.** Digital has been one of the few real beneficiaries of the crisis. We see three ways in which companies can respond:
   - **Manage your business in real time and digitally.** The POS data has shown that the outbreak has had a significant impact on geographies, channels, and categories. Businesses now operate at a very different

cadence, with decision-making required at much higher levels of granularity and shorter intervals to reflect increased uncertainty. This requires a digital-first approach and agile organizational capabilities. Many companies set up war rooms during the crisis, but had very limited access to information. In future, it will be critical to have a real-time view on inventory and a strategy for deployment across regions. Data and analytics will be important tools.

- **Don't just sell online; engage your customers digitally end-to-end.** Chinese consumers increasingly demand an omnichannel experience, meaning they want more than to be sold to online. One premium apparel retailer has deployed a range of solutions, including enabling sales reps to use WeChat groups to reach out to VIP customers with individualized products (supported by a CRM system), launching social media shows with with Key Opinion Leaders (KOLs), and ramping up content marketing. The bottom line is that companies must engage the entire organization to prepare for an omnichannel world. This requires a digital network architecture, backed by a dedicated operational set up, KPIs, and objectives and key results (OKR) frameworks that can help the organization define goals and track outcomes.
- **Transform your business model.** To increase operating efficiency and effectiveness, companies should aim to incorporate technology across the business. Before COVID-19, retailers were already deploying digital use cases, including seamless check out, pricing, promotions, assortment optimization, and robotic process automation in the back office. However, few retailers managed to scale across the value chain, typically because of factors including a lack of top-down ownership and ambition, insufficient capabilities, siloed ways-of-working, outsourced IT functions, and legacy systems. COVID-19 has shown the need to transform the business model to be more tech-enabled, which will both help the company operate under the constraints of pandemics and meet customer safety needs. The business case is there: tech can improve sales efficiency by 2-5 percent and, depending on starting position, drive sales and make or break market share during a crisis. Retailers need to pursue a triple transformation of people (new capabilities and ways of working), technology (modularizing core tech and deploying software-as-a-service across the value chain) and business (delivering value for the customer).

3. **Align with consumer trends: healthy, local, and delivering value.** The data shows that the trend toward healthier lifestyles accelerated during the COVID-19 outbreak. People also shopped local, both in terms of location and products. For companies with strong cash positions, there is an opportunity to respond, leveraging M&A and hiring to expand into adjacencies such as food services, or acquiring smaller brands that may be struggling.
4. **Transform your supply chain to be agile and resilient.** Supply chains attracted a lot of attention during COVID-19 and we expect they will continue to sit high on executive agendas. During a crisis, it can be dangerous to have a large amount of working capital locked up in inventory and facing potential write-off (or sale at a deep discount). The acceleration of omnichannel also creates a real challenge for many consumer packaged goods brands and retailers, because of the prohibitive cost: growth in online does not imply growth in profits. Companies should use the coming period to transform their supply chains, accelerating decision making to become more efficient, agile, and resilient.

As executives consider their options, these strategies may help them support resilience and lay the foundations for the 'next normal' in the months ahead. Retailers and consumer brands have been challenged in recent months, but those that can act decisively on all four fronts are likely to emerge ahead of their peers once the crisis is over.

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The authors wish to thank Glenn Leibowitz, Jack Cai, Judy Xu, Lily Guo, Mengzhu Xie, Ray Liu, Yannan Bu and Yunfei Shi for their contributions to this article.

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Winning the future of grocery retail in China

Amid widespread closures of shops and workplaces, China's grocery ecosystems emerged as beacons of resilience, their lights on and deliveries running through otherwise silent cities.

Alex Sawaya, Daniel Zipser, Dymfke Kuijpers, Felix Poh , Joanna Mak, Lambert Bu

The outbreak of COVID-19 in China has irrevocably changed the domestic retail landscape. Nowhere is this more apparent than in the market for groceries, the essential foods and products that consumers need to sustain their daily lives. That definition might seem unnecessary, but it serves to recall the pivotal role China's grocery stores played in keeping the country on its feet, or rather off its feet and safe at home, during the height of the COVID-19 crisis. Amid widespread closures of shops and workplaces, China's grocery ecosystems emerged as beacons of resilience, their lights on and deliveries running through otherwise silent cities.

In the following article, we identify six trends underpinning the growth of grocery retail in China, explore how leading players adapted to the challenge of COVID-19, and offer a view on what companies can do to win the future of the market in China.

Six structural trends propelling China's grocery retail market

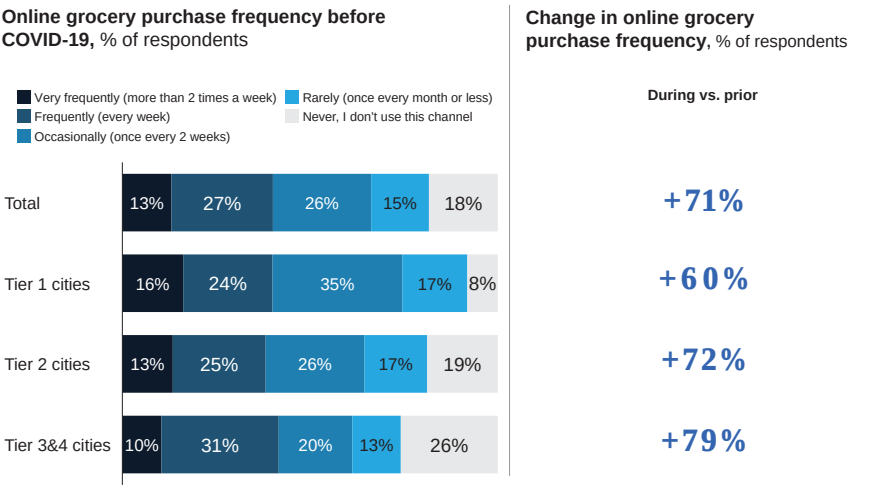
Below, we pick out several important trends driving the growth and development of China's grocery market, and where relevant explain how they have been affected by the outbreak of COVID-19:

1. Online grocery retail will grow significantly as demand is unlocked in lower tier cities

Online grocery retail has been growing at more than 30 percent annually in recent years, helping online penetration reach 10 percent of the market in 2019. More than half of Chinese consumers already buy packaged food online, while more than a third do so for fresh food. According to our COVID-19: China grocery consumer survey, conducted in March 2020, the pandemic has accelerated the overall frequency of online purchases by more than 70 percent, with the shift most pronounced in tier 3 and 4 cities, where demand from both first-timers and infrequent users has been further unlocked (Exhibit 1). These lower tier cities will continue to be a battleground for fresh grocery ecommerce retailers, all of whom are aggressively expanding their coverage while working to resolve logistics and supply chain issues.

Exhibit 1

Online grocery purchase frequency has increased rapidly due to COVID-19



Source: McKinsey COVID-19 mobile survey 3/21-3/23/2020 N = 611 Sampled and balanced to match CN gen pop 18-65 years old

2. Consumers expect convenience and ultra-fast fulfillment for fresh food

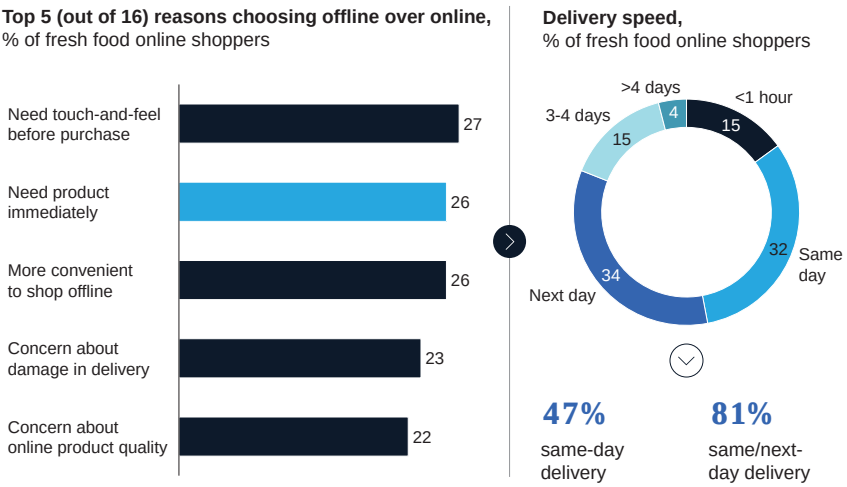
Four out of five Chinese consumers receive their online orders of fresh food the day after order at the latest, while almost half (47 percent) do so on the same day, and 15 percent enjoy delivery within an hour, according to our research (Exhibit 2).

The sophistication of China's ecommerce infrastructure and digital savviness of Generation Z Chinese consumers, or those under the age of 25, are primary drivers of these patterns. According to the McKinsey 2019 Gen Z Asia Survey, 40 percent of Chinese Gen Z respondents rarely visit an offline supermarket, far fewer than older generations in China and their counterparts in other Asian countries. Instead, they source ingredients for home-cooked dinners from online grocery platforms offering ultra-fast delivery, while turning to general ecommerce retailers to stock up on non-perishables, and only visiting offline convenience stores (CVS) for last-minute or impulse purchases.

This convenience-seeking behavior has encouraged openings of neighborhood fresh food marts, which are expected to lift sales at such small formats by more than 20 percent annually. Unless hypermarkets take significant remedial action, they are set to lose market share as a result of shifting consumer habits and a sub-optimal category mix.

Exhibit 2

More than 80% of fresh food are delivered within the next day



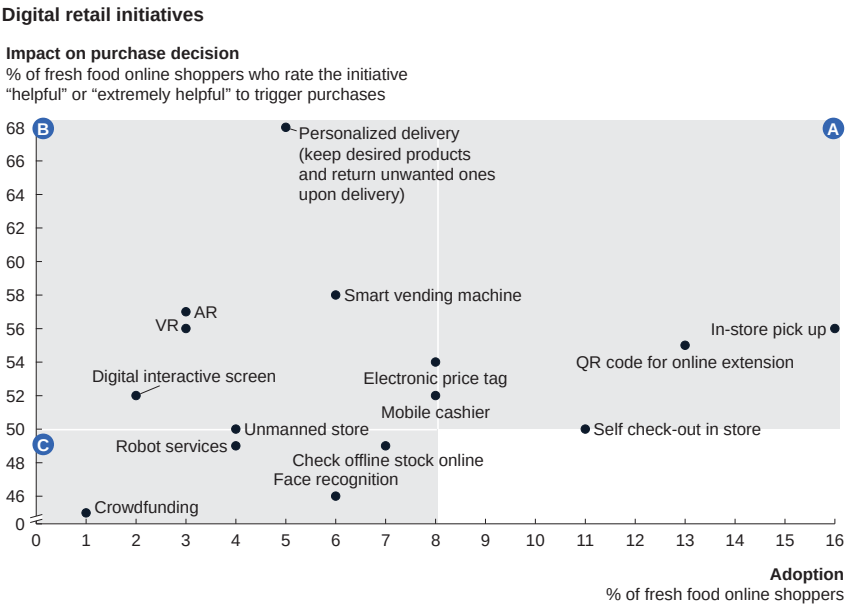
Source: McKinsey China digital consumer survey 2019

3. Omnichannel services are more widely accepted, but in-store digitization has yet to take hold

Omnichannel services such as in-store pick-up of online orders, QR code scanning of products to reveal more information, and self-check-out are the most widely adopted digital retail concepts in China, while robot services and facial recognition have yet to be widely commercialized (Exhibit 3). In-store digitization initiatives including augmented and virtual reality have high potential, as do smart vending machines and electronic price-tagging, as they are strongly appreciated by online shoppers in the limited cases where they have been deployed, according to McKinsey's China digital consumer trends report.

Exhibit 3

In-store pick up, QR code and self check-out are the most widely adopted digital retail initiatives



A

Omnichannel fulfillment services such as in-store pickup is widely adopted and appealing to consumers

B

In-store digitization initiatives such as AR and VR shopping, e-price tags, mobile cashiers, and interactive digital screens, are lower adoption but big potential for impact

New retail formats like smart vending machines and unmanned stores are also appealing

C

Adoption and perceived impact of **digitization concepts** such as **robot services** and **facial recognition** continue to be low

Source: McKinsey China digital consumer survey 2019

Meanwhile, community group-buying start-ups have rapidly formed a 29 billion RMB market. Leading players such as Xingsheng Selected leverage WeChat-hosted buying platforms to offer attractively-priced products, benefitting from efficient community referral models, and a scalable supply chain. These factors have enabled Xingsheng Selected to rapidly penetrate lower tier cities, and achieve close to break-even economics. Founded in 2017, the platform has already reached gross merchandizing volume of 10 billion RMB, serving 2.5 million monthly active users across 40,000 pickup points in China.

4. Consumers increasingly value quality, health, and safety for both fresh and packaged food

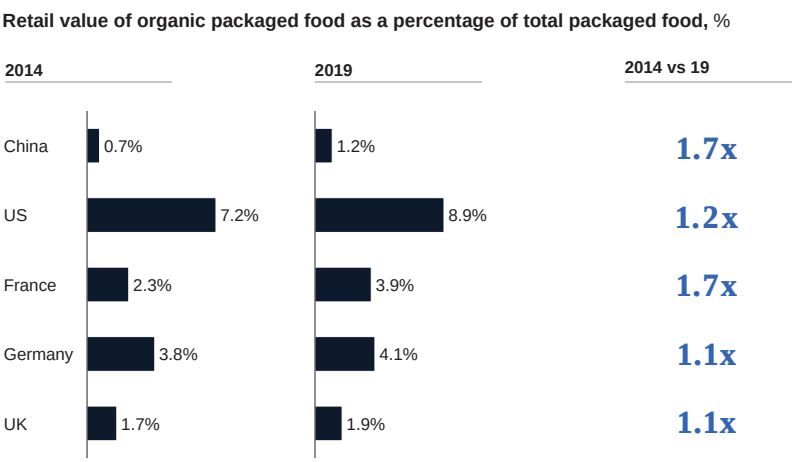
Chinese consumers most value high quality and safe ingredients in the fresh and packaged foods they buy, while COVID-19 has reinforced the importance of deploying easy methods for tracing food back to its origin. Retailers are meeting this expectation by directly purchasing food from farms, and improving supply chain technologies to reassure customers about the provenance of products.

There is room for catch up growth in organic foods, in part because China still lags behind other developed markets in terms of the retail value of organic packaged food as a proportion of total packaged food. The COVID-19 crisis will also likely accelerate consumer appreciation of products they can confidently trace from farm to table.

In the meantime, China's grocery market is notable for a considerable gap between claimed intent to purchase organic foods and actual spending: about a third of consumers say they prefer organic but only 1 percent actually purchase (Exhibit 4). For Chinese consumers, perceptions of quality and safety extend beyond the origin of food to include packaging and design; fruit wrapped in plastic being a prominent example.

Exhibit 4

China's organic packaged food retail penetration is lower than developed markets



Source: Expert interviews, Euromonitor, Mintel

Agility, resilience, and partnerships: How grocery retailers overcame the COVID-19 crisis

Keeping grocery supplies in China moving during the height of the COVID-19 crisis was no easy task, but retailers that succeeded in consistently serving anxious consumers were rewarded with first-quarter sales up to triple the levels of the previous year. As part of this deep dive into the Future of Grocery Retail, we assessed how these retailers were able to meet the challenges of China's lockdown. We found that the most successful grocers, including Yonghui, JD and Alibaba Group's Freshippo, adjusted at every point along the supply chain, from sourcing and warehousing, to distribution and last mile delivery.

Their stories are characterized by agility, resilience, and an appreciation of partnerships, not to mention an understanding that COVID-19 was accelerating market trends. Chief among these was a shift to online ordering. This trend was initially enforced by lockdown, but we believe it will persist because Chinese consumers found the experience seamless and rewarding, unlike their counterparts in less digitally advanced markets.

Yonghui worked with several online ordering platforms to establish community ordering and pick-up points for contactless deliveries, lifting overall sales by 20 percent as a result. Freshippo was agile enough to reassign headquarter staff to sorting, pricing, and packaging jobs, while JD Supermarket tapped partner DaDa Express' app to hire tens of thousands of last-mile delivery personnel in double-quick time.

In terms of resilience, self-ownership of logistics allowed JD Supermarket to rapidly shift half of its storage allocation from electronics to essentials, thereby ensuring continuity of supply and sales. Established modern trade retailers adapted by increasing orders from longstanding procurement partners, while reaching out to local governments to help expand their fresh food supplier base, and secure transport permits.

Meanwhile, Freshippo shared supplies, inventories, warehousing, and consumer data across its digital ecommerce platforms with Tmall, Taobao Partners, and RT-Mart. This enabled them to maintain stock levels, improve marketing efficiency, and ultimately double their online sales of essentials.

Across the board, we observed grocery retail winners taking strategic actions to enable them to better withstand future market shocks. These include increasing investments in upstream suppliers, rethinking customer acquisition and inventory management, and deepening ecosystem partnerships that proved their mettle in the heat of the COVID-19 crisis.

5. The role of private labels is increasing, albeit from a low base

China traditionally has had a low proportion of private label products versus developed markets. However, leading grocery players with strong branding are spearheading an increase in private label penetration, especially Alibaba Group's Freshippo, which is investing ambitiously to reshape the market. In order for the private label market to take-off, consumers must perceive private labels as "high quality, value for money" rather than as cut-price alternatives to established brands. Private labels can also help alleviate margin pressure due to intensifying competition.

6. Grocery retailers are revamping foodservice models

In order to attract footfall to offline stores, grocery retailers have introduced foodservice to their outlets, but only a few have succeeded. Freshippo helped reinvent the "Grocery + foodservice" model and attract diners to stores by offering high-end ingredients with high perceived value. Key success factors of foodservice models include strategic partnerships with food service brands, innovative menu concepts, and synergies between food service and fresh grocery operations to reduce fresh food shrinkage.

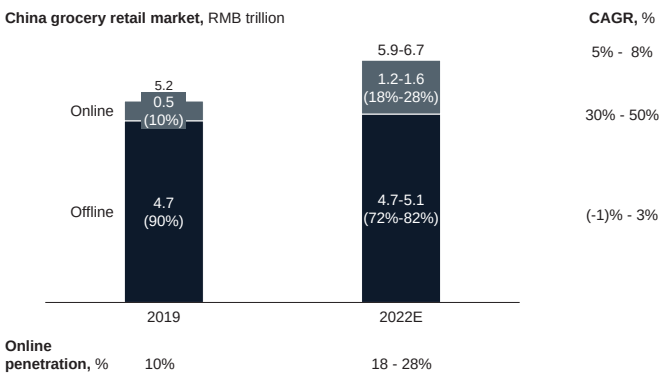
COVID-19 is accelerating these structural trends, particularly the shift to online ordering, and consumers' growing preference for quality, healthy, and safe products. Grocery retailers should adapt by investing in online and omnichannel initiatives, particularly those that help reassure consumers about the integrity and health benefits of the products they buy.

Scanning the future: What will China's grocery retail market look like in 2022?

In order to assist grocery retail executives in understanding ongoing shifts in competitive dynamics, we developed a robust framework to forecast how China's grocery market, and the different players involved, might evolve by 2022. Our proprietary model leveraged consensus forecasts for the economy, as well as estimates of the size of the overall grocery market, and of channel and category growth. Our core takeaway is that, consistent with most expectations, offline grocery retail will continue to account for the bulk of sales, even as online drives almost the entirety of market growth. We estimate that the total value of grocery retail sales will grow in the mid-single digits annually, in line with GDP growth, to reach up to 6.7 trillion RMB in 2022. During that time, online will likely increase its share of total grocery sales from about 10 percent to 18-28 percent, growing at a CAGR of 30-50 percent (Exhibit 5). This expansion will be driven by higher basket sizes due to wider and more premium online assortments, as well as continued investments in consumer acquisition and retention by online players.

Exhibit 5

China grocery retail's online share will continue to rise in the coming years



Source: Euromonitor, expert interviews, McKinsey analysis

We believe there is a potential 400 billion RMB opportunity for offline grocery retailers that can adjust their formats in line with shifting consumer behavior. We expect modern grocery retailers, which account for around 50 percent of the market, to claim the bulk of this potential market by rejuvenating their formats, with early experimentation involving smaller stores covering wider consumer segments, for example focusing primarily on packed or unpacked fresh foods, offering strong potential. New retail players, including omnichannel players, neighborhood food marts, and tech-enabled convenience stores,

which currently account for less than 5 percent of the total market but are forecast to grow at 30 percent annually, could also capture share with innovative business models. Other offline formats such as wet markets, which account for 30 percent of the market, will lose share to modern offline and online channels.

Established ecommerce players will likely continue to lead online sales, and are forecast to double their market share to reach 10 percent in the next two to three years. We see Alibaba and JD.com driving growth by expanding in both fresh and non-fresh categories. Alibaba would fulfill Tmall orders via regional and chilled distribution centres, using third-party platforms like Ele.me for last-mile delivery, while JD.com would scale up its supply chain, and succeed in reassuring customers over the quality of its fresh produce.

New retail players, alongside fresh food ecommerce and community group purchase start-ups, are expected to capture the highest rate of market growth. Starting from a low base, we expect new retail players to grow at around 40 percent per year by expanding into lower tier cities with profitable smaller formats, once they achieve sustainable economics by improving productivity per store, as well as focusing on rational marketing spending and consolidation.

The extent to which offline retailers enjoy their fair share of online growth and become truly omnichannel largely depends on whether they successfully rethink digitization and form the right partnerships, as we detail below.

Deep dive on offline incumbents: Modern grocery retailers must rethink digitization and partnerships to compete

As consumers increasingly seek online and omnichannel fulfilment, a long tail of smaller players will likely struggle to adapt. Offline incumbents, especially the regional or provincial players, thrive because of their vertically integrated supply chains in fresh food, and dense store networks in comparison with national players. However, China's grocery market landscape is so fragmented that the top 10 supermarket chains only account for 4 percent of the market. Small players with less than 100 stores will find it difficult to attract digital talent, access capital for online traffic acquisition, or manage digital transformation, leaving them reliant on third-party delivery platforms or social platforms to keep pace. For smaller players, accessing online traffic through third-party platforms has few downsides.

Large national offline incumbents face a strategic choice between digitizing through partnerships or doing it themselves. Aside from hosting their banners on delivery platforms as a quick and light way of going online, leading players have chosen to either deepen their partnerships with ecommerce giants, allowing them to develop their online and omnichannel offerings, or digitize their own businesses.

Deepening strategic partnerships with platform players: Walmart's tie-up with JD.com and RT Mart's alliance with Alibaba are salient examples of these win-win partnerships, which allow the offline partner to build out improved digital capabilities across customer relationship management (CRM) and last mile delivery, while leveraging their own procurement strength to improve merchandizing and supply chain management.

Creating self-built digitized operations: Meanwhile, several offline incumbents or tech-savvy convenience stores have evolved viable business models, centered around both in-store digital solutions and back-end digital infrastructure. Wumart's Dmall has potential to transform its forays in this space into tangible business impacts, while Yonghui is developing its own digitized operations to enable both offline and online channels. Several convenience stores could achieve rapid growth by perfecting their use of automation and artificial intelligence to optimize operational efficiency, allowing them to compete in economic terms with mature players. A lean procurement model, strong branding, and improved profitability might also allow players such as QianDama to leverage investor support to expand nationally under a franchise model.

Other imperatives for the offline incumbents to further strengthen their omnichannel position in the coming years include:

1. **Leveraging third-party delivery platforms:** This is a win-win for both parties. Offline retailers can take advantage of low-cost consumer traffic and mature last-mile delivery operations from delivery platform partners to unlock online business opportunities. Delivery platforms can diversify away from restaurant delivery while expanding their user base.
2. **Strengthening fresh food:** The key differentiating factor between incumbent fresh retailers and ecommerce challengers is the former's core competencies in procurement, supply chain, and logistics. This advantage should enable them to aggressively expand and optimize fresh assortments based on consumer insights.
3. **Overcoming internal organizational challenges:** This is often an overlooked but important issue to address. Adjust existing organizational structures for growth and new capabilities, for example by establishing a dedicated unit for online business, while shifting mindsets and hiring new talent to drive successful transformation.

The majority of growth in the next few years will likely come from leading modern players who re-invent themselves in the digital era, ecommerce players, and new retail challengers. The profit pool will shift from incumbents to this set of players after accounting for cannibalization and improvement in online profitability.

Conclusion

While the post-COVID-19 outlook is still uncertain, the changes the virus has wrought on China's grocery market are already in train. Consumers increasingly want convenience, whether online or in-store, combined with the option to buy healthy, fresh, and safe products. A battle for the future of the market is already underway, with incumbent offline retailers vying for relevance with the new entrants. Whatever comes next, China's grocery market will continue to develop in dynamic and exciting ways as some of the world's most innovative retail companies compete to deliver daily necessities in the world's second-largest consumer market.

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The authors wish to thank Ronald Yim, Claire Gu, Lu Yu and Hao Lu for their contributions to this article.

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What can other countries learn from China's travel recovery path?

In May, we asked how much the world could learn from China's postpandemic travel recovery. Now, we explore where lessons from the latest data from China may be relevant for other countries.

Guang Chen, Will Enger, Steve Saxon, Jackey Yu

While the path of the travel and tourism recovery will vary by market, China's distinct experience may hold lessons for other markets—particularly those where, as in China, COVID-19 transmission rates are low and traveler confidence has recovered quickly.

In May 2020, we conducted a survey of Chinese travelers; based on these results, we predicted that the domestic travel market would recover quickly. A follow-up survey in August further explored the key emerging travel trends, how traveler behavior and sentiment has evolved, and the implications for global travel industry players. Using the same methodology, we surveyed respondents from eight Chinese cities,[1] all of whom had traveled domestically or overseas in the past year. We compared data collected from August 22 to August 28, 2020, with the previous two rounds of surveys.

In this article, we update our survey findings and offer insights on what lessons other markets, individual global travel and tourism companies, and the industry as a whole might take from China's recovery.

What are we seeing in China?

Demand for domestic travel is approaching prepandemic levels. Hotel-occupancy rates and numbers of domestic flight passengers bounced back to around 90 percent of 2019 levels by the end of August, and railway travel also shows a strong recovery (Exhibit 1).

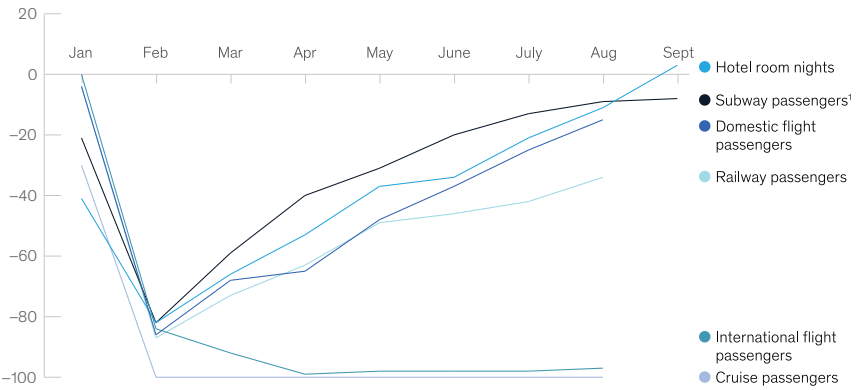
People of all ages are willing to travel again. The proportion of China Travel Sentiment Survey respondents that had travel plans in the four months following the survey rose from 15 percent in May to 70 percent in August. About half of these respondents expected to take their next leisure trip around the National Day holiday at the start of October (Exhibit 2).

[1] We surveyed approximated 2,000 respondents from Beijing, Chengdu, Guangzhou, Shanghai, Shenzhen, Xi'an, Xiamen, and Wuhan.

Exhibit 1

The domestic tourism market in China is recovering rapidly, while international tourism is still domant

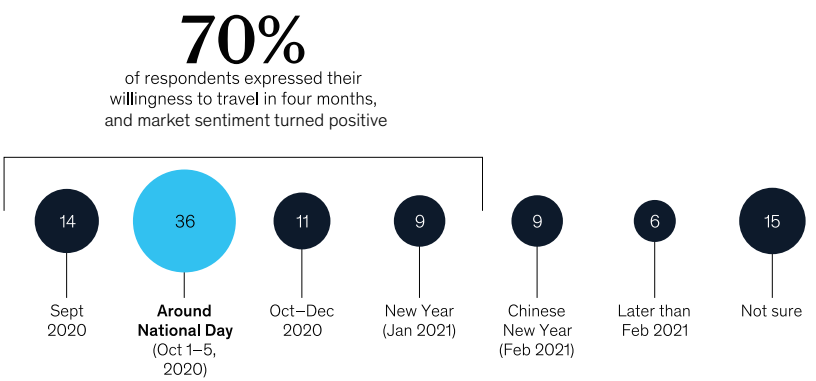
Tourism recovery in China, year-over-year change from 2019 to 2020, %



[1]Based on Chengdu, Guangzhou, and Shanghai.
Source: Ministry of Transport; STR; Wind Investment Terminal; monthly reports of airlines

Exhibit 2

Most Chinese tourists are willing to travel starting around National Day



Source: Travel Sentiment Survey of Chinese tourists, August 2020 (n = 1,532)

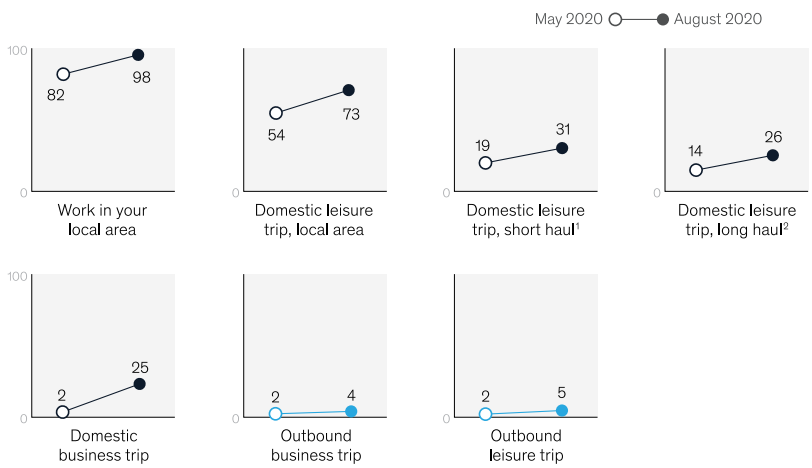
Looking at age demographics, 75 percent of the young (those aged 25 to 34 years), 77 percent of the elderly (aged 55 to 64 years), and 78 percent of retirees expressed a particularly strong willingness to travel.

All types of domestic travel have bounced back. Since May, all types of domestic travel—including local leisure trips, domestic short haul and long haul, and domestic business travel—have experienced a significant resurgence (Exhibit 3). The proportion of respondents who had taken local urban leisure trips in the preceding two weeks increased from 54 percent in May to 73 percent in August, for example. The percentage of respondents who took domestic short-distance trips also increased from 19 percent to 31 percent over the same period, and those who had taken a domestic business trip increased from 2 percent to 25 percent.

Exhibit 3

Domestic travel sees significant increase, while outbound travel is still paused

"In the past two weeks, did you go out for the following activities?," % of respondents (weighted)

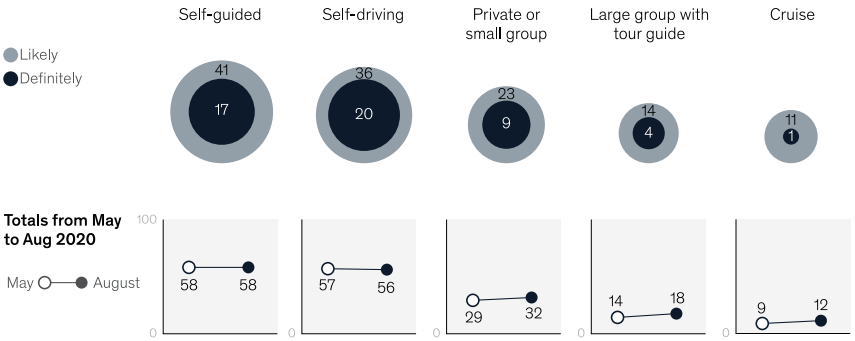


[1]One to two nights, or fewer than three hours' drive.
[2]Three or more nights.
Source: Travel Sentiment Survey of Chinese tourists, May 2020 (n = 1,569), August 2020 (n = 1,532)

Exhibit 4

Self-guided or self-driving tours are still the most popular types

"How likely would you choose the following options for your next leisure trip?," % of respondents who rated 4 or higher on a scale of 1–5



Source: Travel Sentiment Survey of Chinese tourists, May 2020 (n = 1,569), August 2020 (n = 1,532)

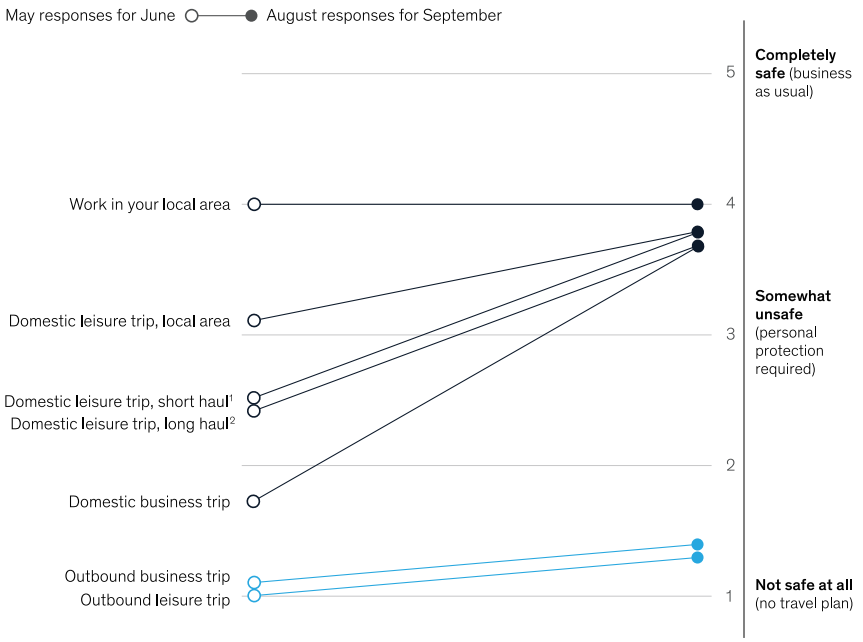
The preferred format of leisure trips has seen little shift. As in May, most survey respondents would likely choose a self-guided tour or road trip for their next leisure trip (Exhibit 4). However, the proportion of respondents who would consider group tours or a cruise for their next trip has increased modestly: 32 percent of August respondents would "definitely" or "likely" choose a small group tour for their next leisure trip, for example, compared with 29 percent in May.

Confidence in domestic-travel safety continues to rise—but has not yet reached precrisis levels. Consumers were asked to rank their confidence in a number of different forms of travel on a scale of one to five, where one represented "not safe at all" and five represented "completely safe." Safety perceptions have increased significantly since May for domestic leisure trips, and—should this trend continue—would rapidly approach completely safe levels (Exhibit 5). Outbound trips, by contrast, are still considered unsafe.

Exhibit 5

Confidence in domestic travel is nearing 'completely safe,' while that in outbound travel remains at 'unsafe'

"How safe do you feel about the following types of travel in the coming one month? Please rate on a 1–5 scale," average safety-assessment score by respondents (weighted)



[1]One to two nights, or fewer than three hours' drive.
[2]Three or more nights.
Source: Travel Sentiment Survey of Chinese tourists, May 2020 (n = 1,569), August 2020 (n = 1,532)

Restrictive measures are being lifted, though some rules remain. The number of local cases of COVID-19 has hovered around zero in most parts of China, leading these low-risk areas to lift many restrictions, such as physical-distancing measures and mandatory nucleic acid testing, for traveling in and out of certain areas. Within dynamically defined safe zones, traveling and daily activities are almost back to normal, though some precautions—such as health QR-code monitoring, travel tracking, and mandatory mask wearing on public transport—do remain in place. In addition, institutions such as schools continue to implement their own travel restrictions.

Some types of travel, especially high-end travel, are booming. Borders remain closed for outbound travel, which means that domestic high-end leisure trips are booming. Occupancy rates at luxury and high-end hotels were back at 85 percent of 2019 figures by the end of August,[2] representing a significantly faster recovery rate than that seen by midrange and economy hotels. In September, the average price for five-star hotels on leading online-travel-agency (OTA) platforms was up 10 to 15 percent year over year for trips over the National Day holiday in October. Furthermore, leisure travel to destinations in Western China and Hainan Province—which boast beautiful scenery, outdoor activities, and beach resorts—have seen significant growth.

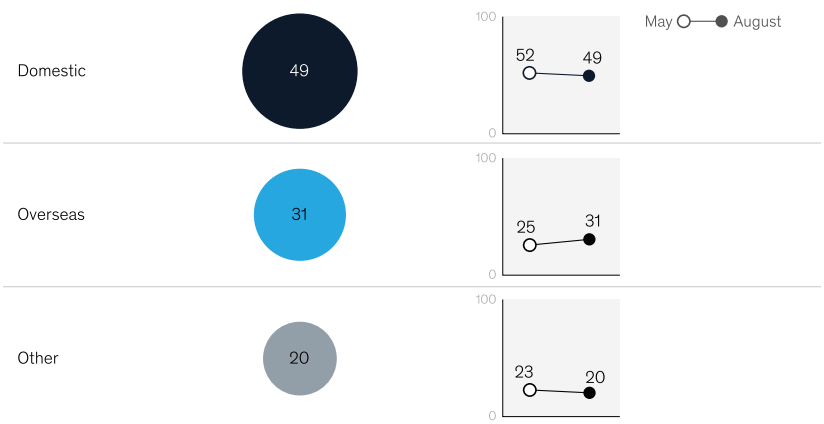
Price cuts were initially used to stimulate demand. Many travel and tourism businesses offered discounts in the immediate aftermath of the crisis in order to compete for business and stimulate demand. Some airlines, such as China Eastern, offered unlimited-flight passes, and airfares fell by a national average of 40 percent from January to June.

International travel remains off the table. With strict restrictions on the number of weekly international flights and mandatory centralized quarantine for arrivals, international travel is still mostly limited to essential trips. Latent demand for trips abroad appears to be significant, however, with the proportion of respondents who expect to go overseas for their next leisure trip rising from 25 percent in May to 31 percent in August (Exhibit 6).

Exhibit 6

The attractiveness of domestic attractions sees a slight dip, while that of overseas countries increases.

"Where do you expect to go first for your next leisure trip?," % of respondents (weighted)



Source: Travel Sentiment Survey of Chinese tourists, May 2020 (n = 1,569), August 2020 (n = 1,532)

[2] Analysis of data from STR, updated August 2020.

The recovery of international travel is likely to be gradual. Keeping COVID-19 contraction rates close to zero is a high priority of the Chinese government; rising rates of local contraction in any region would lead to a risk-level reassessment in a manner that would significantly disrupt daily life.

As a result, China has not yet established any international travel bubbles. Mainland China has, however, begun the process of opening its border to the special administrative region of Macau, which is currently classified as low risk. The border between Macau and Guangdong Province opened in August, and tourists from other low-risk regions on the mainland were able to apply for travel permits starting in September. These travelers will be spared mandatory quarantine, though they will still need a nucleic-acid-test certificate and a health QR code. This gradual process could serve as a model for further easing cross-border travel restrictions in the near future. Preconditions for additional border openings are likely to include mutual formal recognition of low-risk status, transparency around heath data and COVID-19 monitoring, and consensus around protocols to manage the risk of further epidemics.

What implications does the China's experience have for the rest of the world?

In order to understand which trends and strategies may apply to other countries, and which may not, it is useful to first distinguish between two broad categories of recovery strategy. Some countries and regions appear to be pursuing a "zero case first" strategy, while others appear to be taking an approach that we refer to as "balance and manage."

The zero-case-first strategy is associated with markets where COVID-19 contraction rates are low and—as a result—traveler confidence level is relatively high. Various types of travel activities (for example, hotel stays and air travel for leisure and business trips) could therefore show a strong domestic recovery.

The focus of the travel and tourism industry in zero-case-first markets may be to accelerate demand recovery and explore more active revenue-management strategies. International travel will likely recover more slowly and be contingent on travel bubbles or corridors forming. China's recovery experience, with its focus on accelerating the return to normalcy for domestic tourism activities, will be of direct relevance for these markets.

The balance-and-manage strategy is associated with markets where the contraction rate of COVID-19—and the resulting level of anxiety around travel—tend to be higher. For example, contraction rates in the United States remained high in May, when 49 percent of survey respondents said they were "extremely anxious" about flying. Travel in balance-and-manage markets tends to be limited to essential trips, which means the rate of recovery is low, and key metrics (such as hotel occupancy and flight bookings) still show a large year-over-year performance gap.

The primary focus of balance-and-manage markets could be to rebuild confidence through the implementation of health and safety measures. Opening international travel to other countries with similar strategies and risk levels and allowing economic activity to resume may be possible earlier than for markets adopting the zero-case-first strategy. Lessons from China may be less directly relevant in these balance-and-manage markets, though looking at Chinese consumer-behavior patterns may be valuable in predicting the general shape of the recovery once travel confidence is restored.

Lessons for companies operating in a zero-case-first market

Companies operating in markets with very low transmission rates may focus on rebuilding domestic demand, finding new channels, or exploring opportunities for travel bubbles.

Rebuild demand, then enhance value

Rebuilding demand and propelling volume (such as through discounts and presales) are key during the early stages of recovery. As demand grows and confidence increases, indicators such as hotel occupancy and the number of domestic air travel passengers might approach prepandemic levels. Companies could explore opportunities to bundle products (thereby offering upsell and cross-sell opportunities), as well as to diversify their revenue stream, and enhance premium product and pricing.

Hotels in Shanghai launched an "afternoon tea in the cloud" experience to attract affluent young people. Other destinations and hotels could capitalize on booming demand for outdoor leisure experiences by offering scenic riverside cycling or new watersport activities. Travel companies could also innovate by augmenting their online touchpoints and experiences. This is already starting to happen: some museums have launched video tours with staff and contemporary artists, and cruise lines have launched live-streaming channels to highlight cultural experiences.

As demand grows, there are opportunities to refine optimal pricing mechanisms. This is not something that all countries are getting right; for example, many hotels in Germany may have missed a pricing or revenue-management opportunity when demand for summer travel reemerged.

Focus on domestic

Countries are still in different stages of local lockdowns, and domestic travel may not yet be possible in every market. But, where appropriate, domestic demand can be augmented through a focus on emerging domestic destinations—particularly those that offer outdoor leisure opportunities. This may be best done through cooperation with local government, or with other tourism ecosystem players such as OTAs, attractions, hotels, and airlines. For countries where—as in China—the outflow of high-end tourism-related spending is significant, it will again be important to focus on providing new or improved high-end domestic offerings.

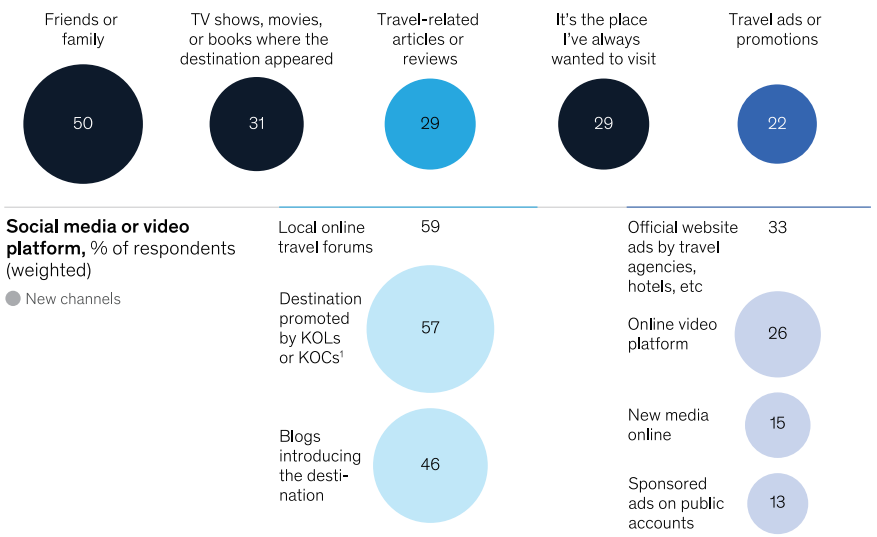
The time for digital is (really) now

The pandemic has accelerated the adoption of mobile and digital tools. Building digital touchpoints and experiences will therefore be essential. In China, social media and new media are now major sources of inspiration and information for travel decisions (Exhibit 7). OTAs and hotel players are adopting livestreaming as a way to boost the sales of travel packages. Some attractions are exploring "cloud travel" to increase broad digital engagement and diversify revenue streams through the online sale of themed products. Strategic collaborations—such as OTAs providing ticket-booking services via instant messaging and through social-media platforms—could also offer an opportunity for increased market penetration.

Exhibit 7

Major sources of information include local online travel agents, traditional travel agencies, and friends and family members.

"Where did you get the inspiration for the destination of your latest trip?," top 5 sources of inspiration (% of respondents, weighted)



[1]Key opinion leaders or key opinion consumers.
Source: Travel Sentiment Survey of Chinese tourists, August 2020 (n = 1,532)

Reopen gradually, in line with travel bubbles where possible

In order to capture early outbound-travel demand, travel players may benefit from tracking the development status of potential travel bubbles. Nearby regions with strong economic ties, low contraction rates, the ability to control their borders (which tends to be easier, for example, for islands), and mature health-risk-management infrastructure could be high potential zones for pilot border-reopening projects. Travel companies will need to be flexible and nimble to capture early international-travel demand—and should be prepared to implement strict health and safety protocols that fulfill the stipulations of both domestic and destination security policies.

In the short term, zero-case-first markets like China should focus on accelerating and capturing emerging growth opportunities and enhancing their high-end offerings, while balance-and-manage markets should continue to focus on building traveler confidence. Thinking ahead, however, travel companies in both markets will need to be adaptive and agile in order to seize postcrisis opportunities and position themselves to thrive within the tourism economy of the future.

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The authors wish to thank Yinlian Bai and Valky Wang for their contributions to this article.

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A perspective on luxury goods companies during and after coronavirus

In these uncertain times, luxury-goods companies must take action to “navigate the now” plan for the recovery, and shape the future.

Antonio Achille, Daniel Zipser

Amid the coronavirus pandemic, every company's first priority is, of course, to protect the health and safety of employees, consumers, and business partners. Indeed, luxury companies have pivoted to address urgent public-health needs: factories that produced scarves and perfume now manufacture face masks and hand sanitizer, and many luxury groups have made monetary donations to hospitals and other not-for-profit organizations. At the same time, with millions of people relying on the luxury-goods industry to make a living—from factory workers and retail-store employees to small-town artisans and craftsmen—industry leaders are planning ahead and wrestling with longer-term strategic questions to ensure the survival of their businesses.

In this article, we discuss the impact of the crisis on the luxury-goods sector. We then recommend two sets of priorities for industry executives: short-term actions for "navigating the now" and longer-term considerations for shaping the future.

A hard reset or a short-term blip?

While it's too early to quantify COVID-19's total financial toll on the sector, the pandemic has certainly shaken some of the foundational aspects of the luxury industry—and some of these changes could be permanent.

Wholesale Darwinism. Even before the pandemic struck, independent luxury-goods wholesalers in Europe (many of which are small, family-owned boutiques) and some of the large North American luxury department stores were already struggling— in part because of luxury brands moving to vertical integration over the past 20 years and, more recently, the growth of e-commerce. This pandemic might force some of them out of business. The damage could extend to brands that have not yet fully transitioned to a vertically integrated distribution model, as well as to upstart brands that need wholesale channels to reach new customers and to finance the development of their full collections. To survive, wholesalers are likely to adopt aggressive commercial and discount policies—which, at

least in the medium term, could hurt the luxury positioning of brands that don't have a concession model.

From global traveler to local shopper. The luxury sector appeals to a global consumer: 20 to 30 percent of industry revenues are generated by consumers making luxury purchases outside their home countries. In 2018, Chinese consumers took more than 150 million trips abroad; we estimate that purchases outside the mainland accounted for more than half of China's luxury spending that year.[1] Asian shoppers buy luxury goods outside their home countries not only to benefit from lower prices in Europe, but also because shopping has become an integral part of the travel experience: buying a brand in its country of origin comes with a sense of authenticity and excitement. With the recent travel restrictions, an important driver of luxury spending has come to a halt, and we anticipate only a gradual ramp-up in international travel, even after the restrictions are lifted. That said, Chinese consumers remain the biggest growth opportunity for the luxury sector. Brands, clearly, will need a new approach to attracting luxury shoppers. To reactivate Asian luxury consumers in their home countries, brands can focus on creating tailored local experiences, strengthening their digital and omnichannel offerings, and engaging more deeply with consumers in tier-two and -three cities. The latter will be challenging, given the limitations in both retail infrastructure and customer-service capabilities in those cities.

Shows without live audiences. Fashion weeks and trade shows have been essential ways that brands have maintained vibrant relationships with consumers and trade partners. While we expect some return to normalcy on this front, we also believe that the luxury industry—in close collaboration with fashion-week organizers and trade associations—should explore alternative ways to deliver the same kind of magic that these events offer when there are restrictions on international travel and large gatherings. Industry players might also consider pushing for a coordinated revamping of the fashion calendar, with brands simplifying and streamlining their presentation calendars.

From ownership to experience, and back again. "Experiential luxury"—think high-end hotels, resorts, cruises, and restaurants—has been one of the most dynamic and fast-growing components of the luxury sector. Millennials (those born 1980–95) opted more for experiences and "Instagrammable moments" rather than luxury items. Baby boomers (born 1946–64), too, were moving in this direction, having already accumulated luxury products over the years. While we expect the positive momentum of experiential luxury to persist, it will slow down in the short term as consumers temporarily revert to buying goods over experiences.

[1] Aimee Kim, Lan Luan, and Daniel Zipser, "How young Chinese consumers are reshaping global luxury," April 2019, McKinsey.com.

Hyperpolarization in performance. Even before the crisis, it made little sense to talk about the sector in terms of averages because growth rates and profit margins were so widely spread out. Even within the same segment and price point, luxury brands' growth varied from 40 percent to negative percentages, and earnings from 50 percent to single-digit percentages. We expect further polarization based on three fundamentals: the health of a brand's balance sheet prior to the crisis, the resilience of its operating model (including its digital capacity, the agility of its supply chain, and its dependence on wholesale channels), and its response to COVID-19.

Another chance for 'rare gems'. Over the past decade, European luxury conglomerates, privateequity firms, and, more recently, US fashion groups and Middle Eastern investors eagerly snapped up attractive acquisition targets. As a result of the current crisis, some of these acquirers—particularly those that aren't luxury companies themselves—could find that they have neither the core competencies nor the patience to nurture these high-potential brands, and thus might be willing to put them back on the market. Acquisitions that were once forbiddingly expensive could become viable in the post-crisis period. Such developments could result in further industry consolidation or even the formation of new luxury conglomerates.

Time and again, the luxury industry has proved capable of reinvention. We are confident about the sector's long-term potential. But some brands will emerge from the crisis stronger, while others will struggle to preserve the integrity of their business. Much will depend on their ability to respond to the short-term urgencies related to COVID-19 while simultaneously planning and executing for the future.

More than 40 percent of global luxury goods production happens in Italy—and all the Italian factories, including small, family-based façonniers, have temporarily shut down.

‘Navigating the now’: Immediate priorities

Many luxury executives have demonstrated caring leadership during this crisis. They are prioritizing the safety of employees and customers and proactively communicating with all stakeholders about their new health and safety protocols, crisis-response activities, and the steps they’re taking to keep operations running. At the same time, they must take quick action to ensure that their businesses weather the crisis. Here are short-term actions that company leaders should consider taking.

Review 2020 inventory and rethink 2021 collections. Sales for this year’s spring season are as much as 70 percent lower than last year—not surprising, considering that consumers had little opportunity to explore the spring and summer collections in stores. Decide how to phase in the 2020 fall and winter collections and develop a plan for dealing with unprecedented levels of unsold 2020 inventory—without resorting to steep discounts, which jeopardize brand equity. Stay informed about wholesalers’ and e-retailers’ plans to clear extra inventory. In some cases, inventory swaps might be preferable to aggressive promotions and discounting. One way to use extra inventory could be to reward loyal customers with gifts or other types of giveaways to surprise and delight them, while also whetting their appetite to shop across collections or categories.

Enhance digital engagement. As stores remain closed in many parts of the world, e-commerce is a crucial channel for keeping sales up, communicating with customers, and forging a sense of community around a brand. Accelerate your digital investments and shift media spending to online channels, with a focus on customer activation rather than brand building. Aside from enhancing your own websites, also consider partnerships with reputable e-retailers. Digital marketing could help not only boost online sales but also entice consumers to visit stores once they reopen.

Manage for cash. Set up a cash-control team, with representation from the procurement and sales teams, to examine spending and identify responsible reductions in cash outflow. Review lease contracts and all operating expenses, including marketing spending and events. At the same time, prepare to selectively support wholesalers and department stores by extending accounts-receivable terms and arranging inventory swaps. Work closely with government authorities on a country-by-country basis to find ways to alleviate cash strains with public measures.

Take a ‘cleansheet’ view of demand planning. Review your 2020 budget and inventory plans, assessing COVID-19’s impact on each region and business unit. Adjust revenue and profit forecasts and create incentives for business-unit heads to set new targets. Resist the temptation to push sales at the expense of margins, as a sales-focused approach will likely yield inaccurate demand projections and, consequently, large amounts of unsold inventory.

Assess the strength of your supply chain. More than 40 percent of global luxury-goods production happens in Italy—and all the Italian factories, including small, family-based façonniers (a French term that loosely translates to "contract manufacturers"), have temporarily shut down. Luxury companies should assess, category by category and product by product, where the impact is likely to be felt most acutely. Potential short-term actions include moving inventory across regions and channels, privileging geographic markets that are less affected, and making sure to fulfill online orders. In the medium term, luxury companies should help production partners recover by making prompt payments and restoring production as quickly as possible. If Italy's façonniers do not survive, a signature element of the luxury ecosystem—the craftsmanship that is the result of excellence and skill passed down through generations, and the source of the "Made in Italy" aura—could be lost forever.

Adjust merchandising plans. As consumers' social routines adapt to lockdowns and physical distancing restrictions, we are starting to see changes in buying behavior. For example, some luxury players report that, in terms of price points, high-end and low-end luxury items are proving more resilient than those in the middle of the range, perhaps due to a combination of "revenge spending" (a phrase that refers to pent-up demand for luxury items during or after crises) and a desire to maximize value for money by purchasing functional items. They are also seeing handbags and small leather goods selling better than ready-to-wear apparel during the crisis. Children's wear seems to be doing particularly well. Millennials haven't reduced their spending as much as other adult segments have. These are the observations of a few luxury players, but clearly there is no one-size-fits-all merchandising plan. Brands should carefully analyze sales data and embed consumer insights into their merchandising plans.

Shape the next normal: Longer term considerations

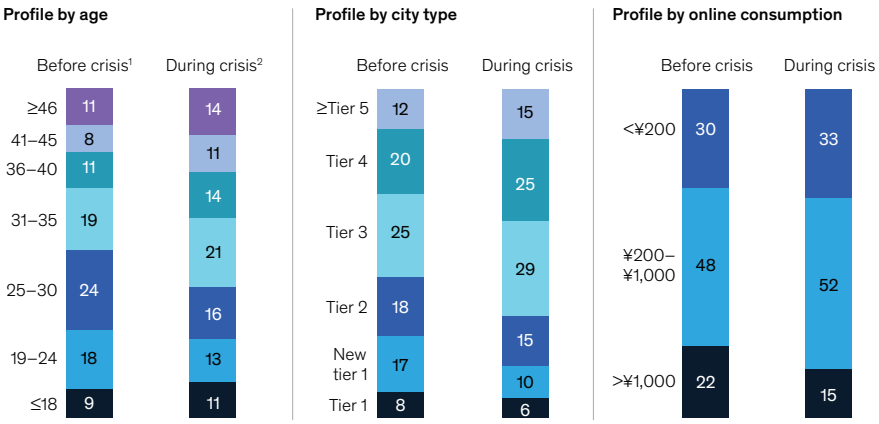
Stabilizing the business during the crisis is crucial—but management must not lose sight of the longer term. Here are strategic actions to consider taking during the recovery.

Put digital at the center of your operating model. For many companies, this crisis has been a catalyst for developing and executing an online and omnichannel strategy. In China, e-commerce has attracted new customer segments and markets (exhibit); we can expect a similar pattern to play out in other geographies. Start by allocating a greater share of investment to the online channel. Explore new ways of partnering with established e-retailers. Step up your personalization efforts in digital marketing. Luxury consumers are accustomed to a high standard of service in stores; the emphasis, then, should be on creating a personalized digital experience of the same quality.

Exhibit

In China, e-commerce user profiles shifted during the coronavirus outbreak.

E-commerce user profiles before and during COVID-19 crisis in China, %



[1]Data from Jan 14, 2020, to Jan 31, 2020.
[2]Data from Feb 3, 2020, to Feb 16, 2020.
Source: QuestMobile

Build competencies related to resilience and transformation. For the past 30 years, the luxury sector has created value, thanks to its creativity and innovation. In addition to supporting core competencies such as design, marketing, and merchandising, luxury businesses now need to build the managerial talent to support the CEO in resilience and transformation. One possibility is to create a new C-suite position, the chief transformation officer, to emphasize the importance of these competencies.[2]

Boldly reshape the ecosystem, including through M&A. Crises can create new avenues for growth. Companies should ask themselves questions such as: "Are there companies we could potentially partner with, both to keep them in business and to allow us to expand into adjacent markets or product categories? Are there moves along the value chain (such as vertical integration) that have become more attractive? What partnerships or acquisitions—perhaps in the technology arena—could we pursue now that were less viable before? What brands could we acquire to complement our portfolio or to initiate our journey toward becoming a larger luxury group?" As companies seek to form partnerships or make acquisitions, it will be important to consider not just economic rationales but social rationales as well: For example, could an M&A deal help a supplier in distress, save jobs in a struggling community, or strengthen the luxury sector for the longer term?

[2] Olivier Gorter, Richard Hudson, and Jesse Scott, "The role of the chief transformation officer," November 2016, McKinsey.com.

Anticipate shifts in consumer sentiment and behavior. Consumers are the ultimate shareholders of the luxury sector. We expect that, once conditions allow, consumers will want to resume their normal lives. However, the next normal might look quite different; luxury companies must try to anticipate and respond to whatever that next normal will be. For example, in our recent conversations with CEOs, one trend that is likely to intensify postcrisis is the trend toward sustainability and the desire for more responsible consumption—reinforcing the need for companies to provide clear, detailed information about their processes and products. Experience also suggests that, after a large-scale crisis with a heavy emotional toll, consumer preferences could shift, at least for a time, toward "silent luxury"—paying more attention to classic elements, such as craftsmanship and heritage, and less to conspicuousness and "bling."

Digitize the end-to-end supply chain. Technology—from remote-working platforms to virtual showrooms—can help luxury companies maintain productivity during the crisis and, perhaps, even improve productivity for good. In addition, the commercial elements (such as virtual showrooms and digital prototyping and sampling) will be valuable in maintaining strong relationships with buyers, even during times when travel restrictions are in place. Digitizing the supply chain from end to end will, of course, require investment in innovative, leading-edge technologies.

While the COVID-19 pandemic has made for a challenging 2020, we are confident that, with careful planning and deft execution, the luxury-goods sector can successfully weather the crisis and emerge even stronger. The actions we've outlined here can help you and the other leaders in your organization navigate the challenges of today while building and strengthening your business for the longer term.

Antonio Achille is a Senior Partner in McKinsey & Company's Milan office; **Daniel Zipser** is a Senior Partner in the Shenzhen office.

The authors wish to thank Anita Balchandani, Achim Berg, Raphael Buck, Aimee Kim, Emanuele Pedrotti, and Althea Peng for their contributions to this article.

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The driver's seat: Leadership perspectives

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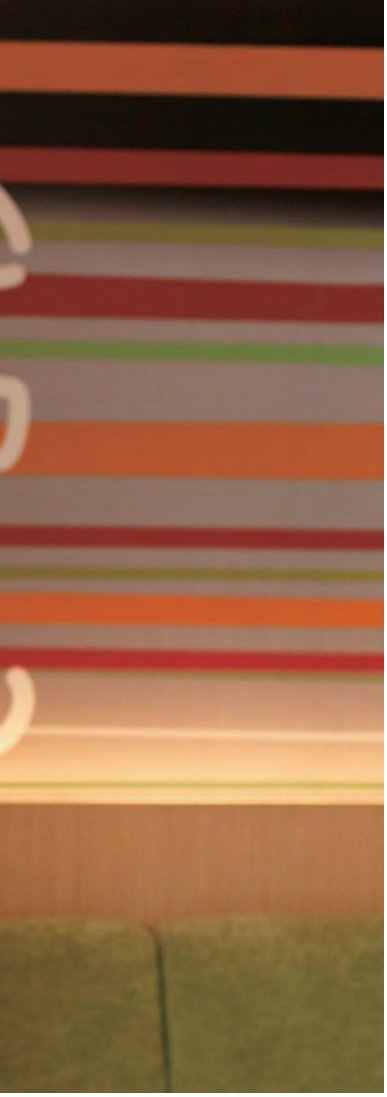
Leading through a crisis: How McDonald's China CEO Phyllis Cheung re-ignited growth during COVID-19

Accelerating store openings in lower-tier cities, expanding off-premise opportunities, and launching new menu items are a few of the ways McDonald's is driving growth in China.

Daniel Zipser, Felix Poh



Introduction

When COVID-19 struck in China earlier this year, most locked-down consumers had little choice but to order meals for home delivery. Many consumers also craved comfort food during a time of anxiety. And they wanted value for money as they feared for their financial future.

For McDonald's China, after temporarily closing all of its restaurants in Hubei province, the epicenter of the virus outbreak, as well as in other locations around the country, the pressure to resume operations was intense. CEO Phyllis Cheung responded by cancelling her vacation to form a crisis response team which focused on keeping their more than 3,000 stores open. She also led a charity initiative to serve meals to emergency first responders in Wuhan, with the initiative subsequently covering all major cities in China.

Cheung recently spoke with Daniel Zipser, a Senior Partner in McKinsey's Shenzhen office, and Felix Poh, a Partner in the Shanghai office, about what she and her team did to lead McDonald's through the crisis and reignite growth.

In their conversation, she explains how McDonald's China is driving growth by accelerating store openings in lower-tier Chinese cities, expanding off-premise opportunities such as drive-thrus, rethinking store formats, and launching new menu items.

Phyllis Cheung

Education:

Holds an executive MBA degree from the Chinese University of Hong Kong. She is a Fellow of the fifth class of the China Fellowship Program and a member of the Aspen Global Leadership Network.

Curriculum Vitae:

Leads McDonald's China as chief executive officer, where she oversees the company's 3,500 restaurants and market expansion strategies.

Selected among the top 100 business women in China for three consecutive years (2017-2019) by Forbes Magazine.

Won advertiser of the year and best employer awards during her time as managing director of McDonald's Singapore and regional manager of McDonald's Malaysia between 2012 and 2014.

Served as McDonald's China chief marketing officer where she led the 2008 Olympics campaign and grew market share to take top position in tier one cities.

Worked with major fast-moving consumer goods companies in Asia as a strategic planner at Leo Burnett, and held positions at other major advertising firms, including Saatchi & Saatchi and J. Walter Thompson.

McKinsey: How did the early part of the COVID-19 outbreak affect you and McDonald's China?

Phyllis Cheung: Initially, crisis response was about establishing safe operations so we could protect our employees and serve consumers. We also asked for volunteers for a charity kitchen program serving first responders in Wuhan, and within 24 hours 300 volunteers turned up. The story of how that team established operations, including obtaining personal protective equipment (PPE) and the precautions they took to disinfect everything, was inspirational in driving a sense of purpose among all restaurant general managers. Subsequently, we had every city's restaurant general managers initiating free meal support for first responders. In looking back, all of our employees are proud of what we have done in serving the community.

McKinsey: How did the crisis affect your working procedures and business operations?

Phyllis Cheung: Footfall dropped dramatically across our stores, many of which are located in transport hubs. Breakfast sales also suffered because people were working from home, and stopped dropping by for a McDonald's breakfast on their way to work. We responded by launching a campaign to reassure consumers we were safe, focusing on brand trust, and our passion for serving the community through contactless service on delivery, contactless mobile ordering, and pick-ups. We also messaged relatives of people working in our crews about the protective measures we were taking, so they felt it was safe for their husband, wife, or children to come back to work. Later, we realized the true power of our billion-dollar brands—that McDonald's has the taste consumers trust, and people were sitting at home craving a Big Mac or McSpicy burger. I can't begin to tell you how many WeChat or Weibo messages I saw on this! Our first advertising campaign post-crisis led with the Big Mac, literally with the message 'I'm here', letting people know that our iconic burger will always be there for them.

McKinsey: Have you seen any opportunities emerge out of this crisis, perhaps in terms of new occasions or interesting consumer behavior?

Phyllis Cheung: Young people were feeling financial pressure as a result of the crisis—about half our customers said they needed to save more money, which helped us focus our response on value and non-discretionary purchases of things like breakfasts and working lunches. In April, people were still uncomfortable with crowds and being inside stores, so we promoted off-premise. Consumers could pick-up food inside or outside restaurants, and we emphasized our service speed so people knew they wouldn't have to spend long inside. The McDonald's global standard speed of service is 210 seconds from the moment you order till you receive your food. In China, our average service time is 150 seconds, among the industry's fastest. Then we activated our membership program and the direct engagement enabled us to bring consumers back quickly.

The opportunity now is around expanding and opening restaurants to serve China's 700 million households. We will continue to accelerate growth in lower-tier cities. The second opportunity is in off-premise convenience. We are focusing on delivery, drive-thru, and mobile order pick-ups. The opportunity as a group, across the portfolio, is in providing even more convenience not just on location, but through the way that we serve; by re-imagining convenience and safety.

Our food offering is another area of opportunity. Consumers rely on us for their main meal occasions, but are seeking more exciting choices, and we are also expanding into new categories—we launched our fried chicken in April, for example. Digital adoption is the final area of potential new growth. Before the crisis, our digital adoption was around 60 percent, but now it is more like 80 percent, including self-ordering kiosks. That growth is driven by mobile ordering and pick-ups. It's like we have made two years of progress in a few months.

McKinsey: You mentioned potential new store formats, what exactly are you thinking of?

Phyllis Cheung: Off-premise is now about 70 percent of our business. It is hard to predict if that is going to be sustained, but it is a trend that will continue even as on-premise returns. We must continue growing on-premise while seeking greater growth in off-premise. In China, we already have many drive-thrus, but we have the opportunity to expand as drive-thru is our key competitive advantage globally.

Now, delivery is the mega trend and is already about 30 percent of total sales. We operate our own rider teams and cooperate with third-party platforms. We also have our own platform, which is going to be big. The rise of mobile pick-ups propels us to rethink restaurant design. How much do we reserve for seating versus bigger catering and kitchen capacity that would allow us to produce food faster? In tier one cities like Beijing, restaurant formats can be smaller because people are looking for fast service; white-collar workers in the central business district have more incidence of 'grab and go'. If you're in a lower-tier city, family occasions remain prominent, so we're still committed to a full-blown dine-in restaurant experience.

McKinsey: Are you adapting to shifts in consumer tastes by offering more wholesome menu choices? Will those choices also be tailored locally?

Phyllis Cheung: We're building more awareness about the changes we've already made, for example reducing salt content and changing our cooking oil to canola blend so there are less saturated fats, which is better for your heart. We are the only QSR in China to use canola blend oil nationwide. We've also added more vegetable choices—you can swap fries for salad or corn. Our Happy Meal complies with China Nutritional Society guidance. Kids get baby fries, a pack of apple slices or salad and a drink, which will be milk or low-sugar juice. Our nutritional transparency enables us to make a sub-500 calorie meal. We have done a lot.

Consumers should start to notice, and we will communicate more proactively as well. Moving forward, we'll do more to open up a new food platform.

McKinsey: Is there any tension between consumers' desire for billion-dollar McDonald's brands versus innovation and menu tailoring?

Phyllis Cheung: Our priority is to adjust to consumer needs with permanent products that will give us repeated visits. For example, the new Angus Burger and McCrispy Chicken that we launched in April address major new markets, just like the McCafé does for coffee drinkers. Having said that, consumers in China are young and dynamic, so we give them lots of excitement through our desserts and beverages. We have frequent ice-cream and beverage 'new news' such as the current durian ice cream and sugarcane bubble McFlurry promotions, which are visually exciting and provide opportunity to tell an interesting story. These are easy innovations that enable us to keep up the excitement while focusing on building the recurring base of billion-dollar brands. We also have intellectual property-inspired food events, for example with Disney, Over the Moon—an animation produced by Oriental DreamWorks which is coming out on Netflix in October—and of course Minions, which we can leverage to offer innovations around 'eater-tainment'.

McKinsey: Did you run into any supply chain challenges at the height of the outbreak, and are you expecting any changes in the supply chain going forward?

Phyllis Cheung: Contingency planning and years of partnerships working with suppliers ensured we had no break in supply. Our very strong local sourcing network for chicken and fresh produce gave us agility and flexibility to adapt to the changing market situation. We were also able to maintain imports of beef and Alaskan fish. We did have some infrastructure challenges because of service disruptions and high stock levels around Chinese New Year, but our resilient supply chain system resolved all the challenges.

After the pandemic, the key is whether we can de-risk potential breaks in supply. Localization, getting more suppliers to be self-sufficient, and finding alternative or secondary suppliers on a global level is the direction.

McKinsey: Western QSR has been a unique food service segment in China over the last 20-25 years. Going forward, where do you see the competition coming from? Do you see Chinese QSRs continuing to scale up?

Phyllis Cheung: Local players with a national footprint are definitely scaling up. Whether in beverages or local cuisines, they are learning and scaling fast, and posing competition. We mustn't forget about convenience stores as well, which pose a unique challenge and are increasingly offering meal options for take-away breakfast and lunch. But Western food still accounts for a small portion of the China market and has massive room to grow.

We're going through a crisis with a near term goal of recovering to our pre-crisis level, but in the long run, consumers here want to improve their living standard and will continue to try new things. Consumption upgrading will persist, and we will adapt our menu choices and store formats accordingly.

McKinsey: What role did McDonald's China play for the rest of McDonald's globally?

Phyllis Cheung: We did a lot of sharing of the pain points and how we solved them, and we also learned a lot from other countries' best practices as well. The good thing is that we helped build increased friendship and trust between the China team and the global team.

McKinsey: Have there been any lasting changes or impact on McDonald's China's working model?

Phyllis Cheung: The restaurant safety measures we put in place will probably be permanent. We still take crew members' daily temperatures. If you buy McDonald's takeaway, the paper bag still carries a record of who prepared it and their body temperature. At the office level, we are cutting back on travel. We found less travel is more efficient.

Digitization is helping us reprioritize what needs to be face-to-face and what can be done remotely. Digital is also helping us rethink operations and productivity, including how we supervise stores and track orders—we have centralized data monitoring that can do this efficiently and help complement market visits.

McKinsey: On a more personal note, were there any leadership lessons or other things that you learned as you managed your team through this outbreak?

Phyllis Cheung: Amid all the uncertainty, clarity of purpose is important to inspire and to guide the whole company. Company values and culture seem to be invisible but are extremely important at times like these. If everyone shares the same values of being passionate in helping others and having pride in serving the community, we will be better people and build a better brand as well. From a business standpoint, it is a good time to reset and to reimagine. I'm excited and energized by the opportunity of accelerating our transformation.

Daniel Zipser is a Senior Partner in McKinsey & Company's Shenzhen office;
Felix Poh is a Partner in the Shanghai office.

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Rewriting China's consumer playbook: An interview with Curt Ferguson, President, Greater China and Korea, The Coca-Cola Company

When COVID-19 struck, there was a playbook in place, and an emergency response team on hand, to help navigate the crisis.

Daniel Zipser, Felix Poh

Introduction

Curt Ferguson has had an eventful career at Coca-Cola. Having served in executive positions during the Ebola epidemic in West Africa, and now COVID-19 in China, Ferguson has deep experience leading through crisis. Being on the ground for those events instilled the 40-year company veteran with a healthy respect for precautionary planning, ensuring that when COVID-19 struck earlier this year, there was a playbook in place, and an emergency response team on hand, to help navigate the crisis.

Under his watch as President of Coca-Cola Greater China and Korea, Ferguson helped ensure that all but a handful of the 47,000 associates employed in a network of 50 bottling plants remained virus-free. He also managed to keep the vast majority of Coca-Cola China's operations up and running, leaving the company well-placed to capitalize on surging demand over the Chinese New Year period. Coca-Cola's ongoing pivot towards health and wellness in China is also proving prescient amid accelerating shifts in consumer tastes as the country emerges from the COVID-19 crisis.

COVID-19 has fundamentally altered the landscape for consumer packaged goods (CPG) companies in China, posing difficult questions for executives as consumers move away from physical outlets in favor of more online ordering. To explain how Coca-Cola in China is responding to these challenges, and what the future looks like for consumer packaged goods (CPG) companies here now that Chinese consumers have rediscovered at-home occasions, Ferguson spoke with Daniel Zipser, a Senior Partner in McKinsey's Shenzhen office, and Felix Poh, a Partner in the Shanghai office:

Curt Ferguson

Education:

Holds a Bachelor of Science degree with majors in Finance and Management from The Indiana University Kelley School of Business.

Graduated from the Executive Development Program at Stanford University and the Executive Management Programs conducted by the Wharton School and Emory University.

Elected to the Academy of Alumni Fellows at Indiana University; serves on the Board of The Indiana University Foundation and the Dean's Advisory Council at the Kelley School of Business.

Curriculum Vitae:

Leads Coca-Cola's operations in Greater China, South Korea, and Mongolia, responsible for a $12 billion retail business, serving more than 1.7 billion people while directly employing 50,000 system associates, and supporting 500,000 additional jobs.

Appointed President of the Coca-Cola Greater China and Korea Business Unit in 2016.

Presided over the company's Middle East and North Africa Business Unit, comprising 34 countries including Pakistan and Afghanistan from 2011.

Served as Senior Regional Director for Coca-Cola's Western Africa region from 2003, before being appointed President of the North and West Africa Division based in Cairo, responsible for 27 countries, in 2005.

Transferred to Asia in 1988, holding a variety of management and bottler positions in Coca-Cola subsidiaries in Thailand, Indonesia, Singapore, Malaysia, Cambodia, Nepal, Sri Lanka and Vietnam.

Joined Coca-Cola in Atlanta, Georgia in 1983.

McKinsey: What are the key changes we are seeing in terms of consumer behavior, channel landscape, and company responses as a result of COVID-19?

Curt Ferguson: Safety was our primary concern during the initial response. Building on our experience in West Africa with Ebola, we ensured there was enough personal protective equipment (PPE) and virus education information not just for all the workers in our franchise bottler plants, but their families as well. At the peak of the crisis, WeChat was an invaluable tool to help communicate safety messaging across the company, and organize different worker groups in our two factories in Wuhan. We also segregated shifts to make sure we contained any potential virus transmission in the workplace.

On the consumer side, everything shifted to online. The out-of-home, on-the-go channel completely shut down, and we cut down our stock-keeping units (SKUs) to focus on a core of three or four. That's all consumers wanted—stuff they knew they could trust: Coke and instant noodles. Later, we looked at offering different multi-packs: mini can multi-packs, which let parents give their kids a treat when they need help around the house. Now, as things go back to normal, people are looking more at health and wellness, which is great for our tea brands, as well as Coca-Cola Fiber and Zero products.

McKinsey: What do you think the 'next normal' will be for CPG players in China, and has there been any longer-term shift in strategic thinking for Coca-Cola?

Curt Ferguson: The acceleration of the online channel has been breath-taking and is here to stay. Except for market visits, I've only been into a supermarket three times since March; I even ordered a dozen eggs on my phone and they arrived in 30 minutes! The hard part is figuring out who pays, the seller or the delivery partner? Meanwhile, the consumer has rediscovered the home and that is also driving change. Cloud kitchens are learning to piggyback on China's phenomenal delivery system. Some are doing 10 different concepts with full menu choices, and delivering to customers who think there are real restaurants involved. I expect to see more of that kind of thing.

All our customers are rethinking what they should do in terms of physical retail. Obviously, in some areas you have to have presence, but to what extent will this be true in the future? Take [Coca-Cola subsidiary] Costa Coffee: it's a retail outlet, but is it there just to prepare coffee, or to offer an experience, or to act as a delivery hub? That's being redefined. Traditional CPG companies like us are defined by the occasion and the channel, by our consumers and our brands. COVID-19 has thrown these all together—the consumer doesn't have to physically experience them except when the product hits their door. That means you have to really define your marketing mix, and what you are going to do with all the money invested in the different channels. COVID-19 has 'unwritten' a lot of rules. We just need to figure out what the new rules are.

McKinsey: Have you found a way to prompt consumers to impulse buy online in the same way they do in-store?

Curt Ferguson: Frankly, the way forward is not 100 percent clear. Some of the out-of-home, on-the-go business is bouncing back—maybe to 80 percent of the pre-COVID-19 level—but some will never come back, so what fills that void? For online, we returned to the old McDonald's formula—back to suggestive selling 101 on a digital basis—such as asking "would you like fries or a Coke with that hamburger?" That's proved to be pretty good. Having said that, we're in the brand business and you want to make sure you're not just a commodity for somebody else to deliver.

McKinsey: What do you think are the key challenges for CPG players and retailers in China in the next 12-18 months?

Curt Ferguson: Coca-Cola's most immediate challenge in China is how to get new equipment for our chilled-milk product joint venture with China Mengniu Dairy installed amid all the restrictions! More broadly, if I'm a bottler, or a traditional CPG company in general, I'm set up to deliver to millions of outlets, but a smartphone can now be an outlet as well. How to get my products to that smartphone, and be top of mind when I do, is a question that's going to keep me awake at night. There are different models to consider, such as setting up subscriptions so that consumers can receive products on a regular basis and working with other parts of the ecosystem while weaving a tighter web around the consumer, but I don't think anybody's cracked that yet.

McKinsey: Have you implemented any new employee engagement initiatives or changed your working model as a result of the crisis?

Curt Ferguson: Our working model favors in-person collaboration, so we are figuring out how we retain our culture if we are stuck with video conferencing. We're looking at forming more agile teams and partnerships because we are not able to have everybody in the room, virtual or otherwise, when initial decisions are made. Getting hold of PPE on time, and protecting our 47,000-plus employees and their families, have gone a long way toward building employee engagement. We made it very simple for everyone to know what was required by setting up a scorecard; whether it was re-opening plants, getting routes going, or figuring out what was driving sales of certain products, we set up clear goals on a step-by-step basis. Initially, Coke Zero sales were up 89 percent, for example, so we went from 'just-in-time' inventory to a 'just-in-case' system that ensured we were covered in the event of a demand surge. That doesn't happen overnight when you have 50 factories and you're selling 75 billion bottles of Coke products throughout China. Amid all the uncertainty, at least we could define things on our own terms, and that focused the employees and the system. Now, we have our highest market share ever.

McKinsey: Given COVID-19 is more under control in China that elsewhere, what do you think Coca-Cola can do in China to set the pace and be the 'best in class' example on crisis response and recovery for Coca-Cola globally?

Curt Ferguson: We put in a tremendous education effort for our Latin American and US associates on how digital was transforming the retail landscape in China for consumers, retailers, and wholesalers. We set up a system to address what was happening in China, and how it would spread. The bottlers—Swire and COFCO—hosted seminars with counterparts in other markets to walk through plant operations, including factory perimeter control measures, temperature checks, and segregating shifts, as well as SKU management. We also discussed how to protect families, transport safely,

and resolve supply chain problems. In fact, we used our supply chains to start supporting other markets. To this day, we're still supplying PPE for plants and customers in the US from our trusted suppliers in China. I'm proud of how we have continually corrected and iterated, so that the shipment process is now much smoother.

McKinsey: Was it difficult to come together and drive towards a common goal? Or was it easy to focus the mind given the crisis at hand?

Curt Ferguson: The scorecard system kept everybody focused. At the same time, we were pulling stock out of our Wuhan plants and trying to get it to the hospitals because in a crisis situation, we always try to supply water as fast as we can. Elsewhere, everybody wanted to keep going; we wanted to show the government we could operate and had the right protocols in place—we never closed our concentrate plant in Shanghai, for example. We were lucky we were up and running because there was a tremendous demand surge as people tried to stock up around Chinese New Year.

McKinsey: More personally, have you learned anything about your leadership style in the course of managing through this outbreak?

Curt Ferguson: Having spent considerable time in the Middle East and West Africa, I've probably been evacuated more times than any executive within Coca-Cola! What I learned from those experiences is how many other leaders came to the forefront. With COVID-19, we put some fairly junior people in charge because they were there, and they showed a real willingness to go the extra mile. We were very fortunate—there was a lot of pressure, a lot of extra hours. We saw five or six strong leaders emerge and they did a fabulous job. The other one is that in China, we were always prepared for things like natural disasters to happen. We have an Immediate Crisis Management Response team in place, which really benefited us. They say you make your own luck—we got extremely lucky on almost everything.

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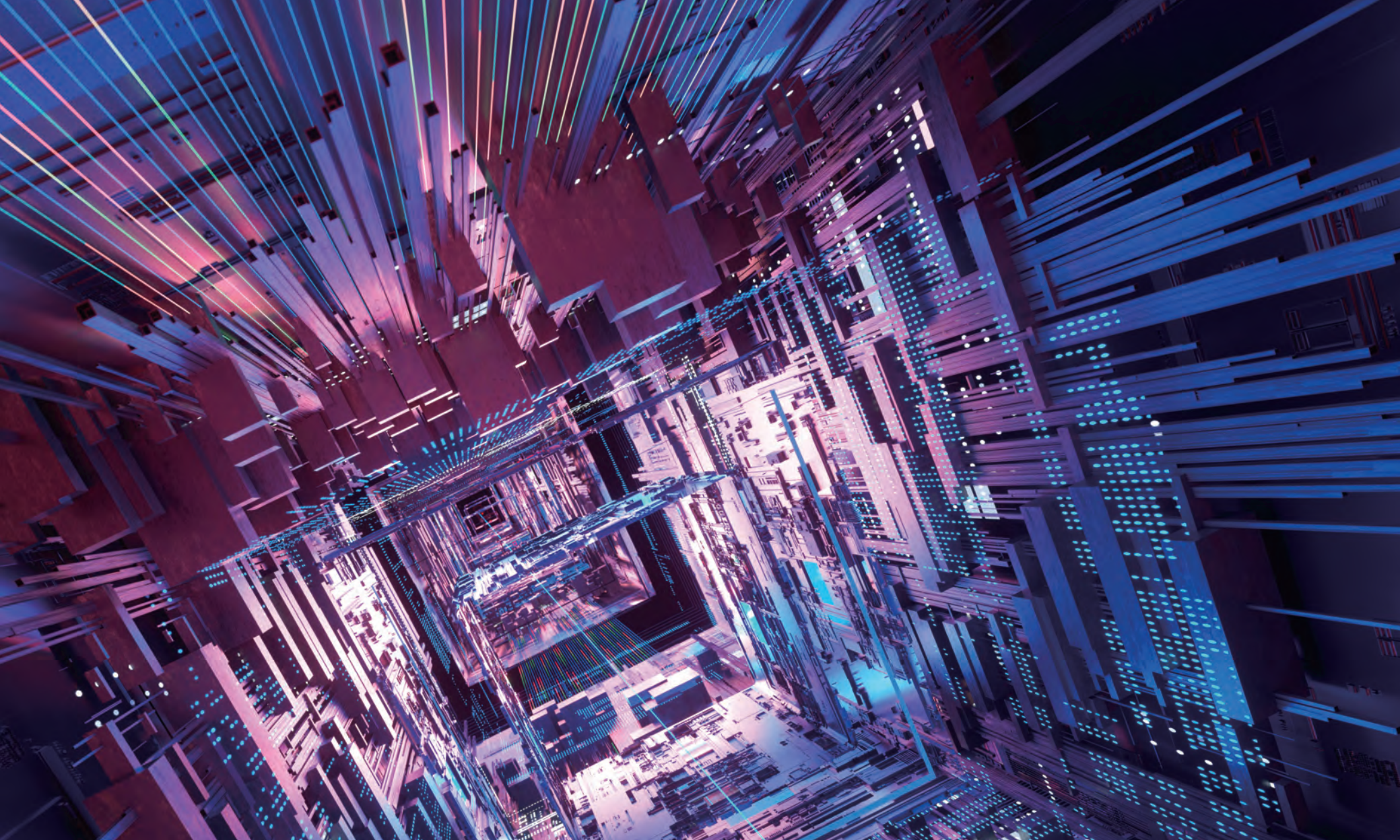

Tuning up for maximum performance: Digital strategies

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Rethinking digital marketing in China

It has never been more challenging to reach China's digital consumers.

Caleb Balloch, David Pountney, Hai Ye, Lambert Bu, Lavonda Li, Lucille Chen

It's never been more important for brands to establish meaningful and valuable digital interactions with consumers. Before the COVID-19 crisis, the appeal of engaging digitally with China's consumers was already very high. On a daily basis, 855 million Chinese consumers were spending an average of six hours on their phones—twice as much as digital consumers in the US—and buying $2 trillion worth of goods and services annually. Now, since China's outbreak and subsequent lockdown, consumers have become even more digital, buying additional products on their phones, such as grocery items, that they previously would have purchased in stores.

It has also never been more challenging to reach China's digital consumers. For one, it's expensive. Before COVID-19, the cost of acquiring new Chinese customers and retaining existing ones was rising by 20 percent a year (for the past three years). When COVID-19 closed stores and cancelled public events, digital marketing costs went up further as virtually every brand doubled their efforts to reach Chinese consumers digitally, with some shifting their entire marketing budgets into digital.

And there is complexity. Brands have a staggering array of options for reaching consumers. The country's mega platforms, such as Alibaba and Tencent, already powerful prior to the pandemic, have grown even more relevant, consolidating their reach across the Internet and touching everything from ecommerce and social media to video, gaming, music, maps, news, and digital payments. While this may sound like a recipe for simplicity, the trend has gone in the opposite direction. Major apps have splintered into hundreds of mini-apps and sub-channels, the popularity of new platforms like Douyin (TikTok) and Bilibili has exploded, and live-streaming has become widely adopted, all leading to what we call the 'dustification' of consumer attention, meaning that outlets for reaching consumers are hyper-fragmented.

Brands also have more options for generating private traffic—communications with consumers that brands have full control over, without the cost of third-party platforms. Tencent's super-app WeChat—a combination

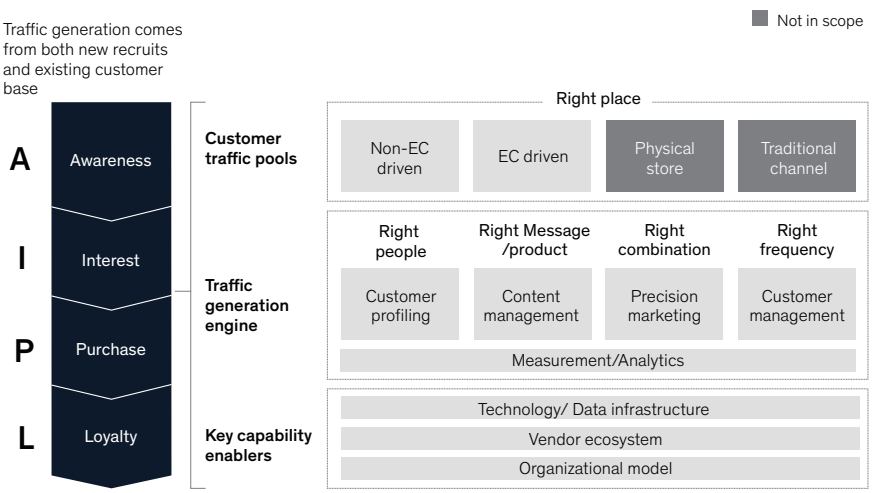
of the functionality of Facebook, Instagram, Skype, and Whatsapp—has pioneered the use of mini-apps that allow brands to connect directly with consumers. This option, which other platforms are now developing, makes every consumer touchpoint trackable and usable, in contrast to "public" traffic from Tmall and JD, which retain ownership of consumer data.

Amid these considerable challenges, leading companies have excelled in generating valuable, revenue-generating traffic in China. When done effectively, digital marketing can increase the size of a brand's target audience by 20 to 40 percent, boost click-through rates by 2-5X, raise marketing return on investment (MROI) by 20 to 30 percent, and grow average revenue per user by as much as 10 percent. In this article, we highlight how brands can apply a systematic approach to navigate and prioritize a very complex marketplace, ultimately achieving their goals of cost effectively connecting with customers and driving considerable value.

The basics of marketing haven't changed—find your target consumers and give them the right product and the right message, at the right place and the right time. The difference in the digital era is that marketing technology, or 'martech', allows brands to accelerate and maximize this basic endeavor at minimal cost (Exhibit 1).

Exhibit 1

Generating quality traffic requires selecting traffic pools and developing traffic engines with strong enablers.



Source: Expert interviews, team discussion

1

A Performance First approach prioritizes the use of tools and capabilities offered by the public ecommerce platforms, and can entail spending 60 percent of the digital marketing budget on these platforms. This typically works best for established brands with a strong existing customer base and high levels of consumer awareness. A leading international beauty brand, for instance, has developed a deep strategic relationship with Alibaba and Tmall.

2

An Internet Celebrity approach uses public social apps and China's thriving "fan economy" of celebrities, key opinion leaders (KOLs), and key opinion consumers (KOCs) to drive brand image and awareness. It's a focus most effective for newer brands, such as China's upstart beauty brand Perfect Diary, which used an Internet Celebrity path to boost sales almost 500 percent CAGR between 2017 and 2019.

3

A Maverick approach seeks to build its own private pools of traffic by funneling consumers to its brand-owned apps and other channels. This method allows brands to capture much of their own customer data and works best for established brands with strong marketing, data analytics, and IT capabilities. A leading sport fashion company, for instance, saw a significant portion of its 2019 ecommerce sales come from its own apps and websites.

4

A Vertical Professional approach also seeks to develop private traffic but with a focus on using social platforms to establish credibility with consumers. This approach is suited to brands with specialized industry or scientific knowledge, such as a leading baby formula brand that seeks to communicate its role as a trusted leader in infant feeding expertise.

Traffic pool selection: Lean into your strengths

To successfully navigate China's cluttered digital marketplace and generate quality traffic, brands have to first take stock of their strengths. This means considering a brand's maturity, the characteristics of the customer base, the investment appetite, and how much control a brand wants over assets such as customer data. Leading companies then use this strategic self-diagnosis to select a core pool of traffic, either public or private, commerce or non-commerce. Although the functionalities of these categories are merging, they are still useful distinctions. An archetype model of four different approaches can help brands think through this prioritization (Exhibit 2).

Exhibit 2

Each archetype focuses on its respective traffic and channels, though they continue to engage in other quadrants.

	1 Performance First	2 Internet Celebrity	3 Maverick	4 Vertical Professional
Key traffic pools	• Public EC platforms	• Public social/ vertical platforms	• Brand-owned website • Brand APP/mini-programs	• Consulting service app • Vertical solutions app
KSF	• Strategic partnership with channel ecosystems in all aspects	• Excellent social content mgt, personalization and optimization	• Strong own channel assets/ capabilities and consistent E2E CEX	• Specialized industry knowledge and professional services
Pros	• Fast technology turnover • Less in-house analytics requirements	• Strong brand exposure • On-trend with UGC	• Strong brand image • ownership over consumer data	• Strong brand image and exposure • Strong conversion
Cons	• Limited control over campaign & customer data • Low bargaining power	• Difficult on conversion and customer journey improvement	• High cost in technology • High in-house marketing capabilities	• Selective industry • High cost in maintenance

Source: Expert interviews, team analysis, Press search

At the same time that successful brands drill down into their core traffic pool, they also need to invest along the edges in other pools in order to capture a broad range of opportunities and take advantage of trends. Creating impactful connections with Chinese consumers is an intricate balancing act that requires the right mix of public versus private and commerce versus non-commerce pools of traffic.

A precise traffic generation engine

Powerful traffic generation engines let brands automate and optimize the identification of the right people (customer profiling), the right product messaging (content management), and the right time and frequency of that messaging (customer management). They also enable the combination of these three elements (precision marketing) and the measurement and analytics of real-time results.

But doing high impact customer profiling, content management, customer management, and precision marketing means choosing among hundreds of possible initiatives, or use cases. To narrow this down, we analyzed brands that excel in traffic generation and determined that between 15 and 20 uses cases is the right number. Collectively, these will cover all the major traffic pools and stages of the marketing funnel, with 5 or 6 of them homing in specifically on a brand's core traffic pool with the goal of developing a competitive advantage (Exhibit 3).

A leading international beauty brand, for instance, taking a Performance First approach, wanted to identify the best marketing content for different consumer segments on its flagship store at Tmall. The company worked with an AI provider to instantly create thousands of layouts with different models, product photos, and colors. Each was dynamically A/B tested with customers to identify those with the highest purchase rate. The result was an ROI boost of 20 percent and a 50 percent reduction in annual design costs.

A baby formula brand, as a Vertical Professional player, organized its most important use cases around the development of a WeChat mini-program that built upon the brand's strengths in community marketing and customer outreach. AI technology was embedded into the program to process data and further segment customers for a precision marketing approach. The conversion rate among existing customers rose from 8 percent at launch at the end of 2019 to 30 percent by the second quarter of 2020.

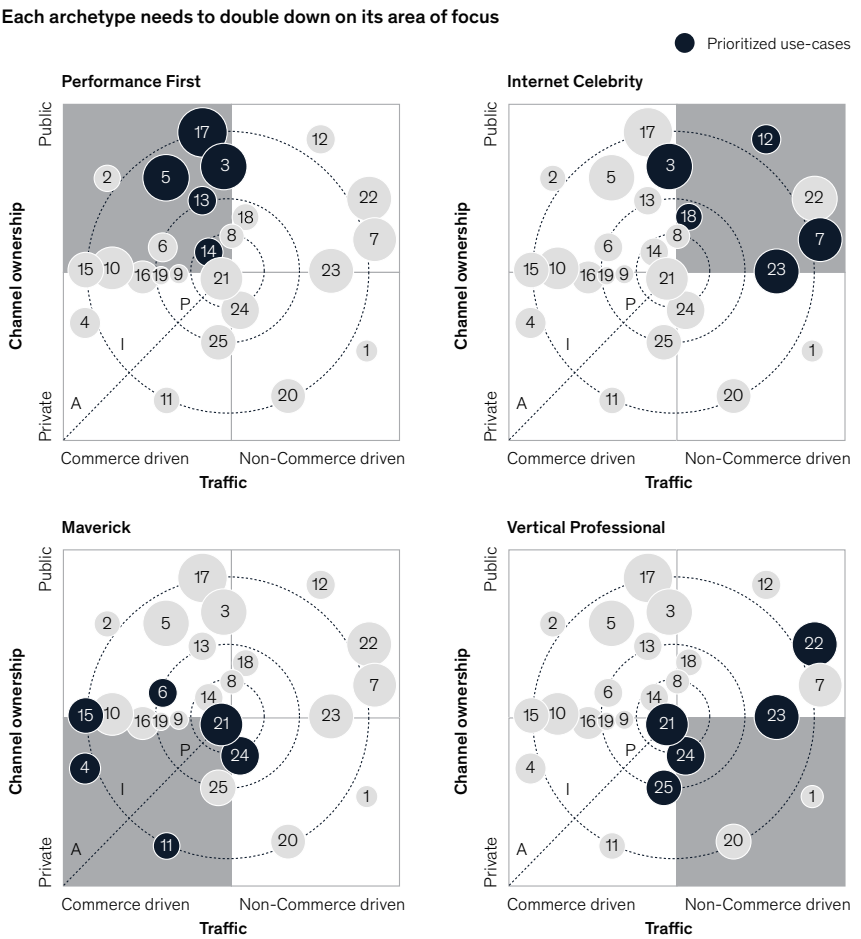
Exhibit 3a

There are 25 top 'traffic engine' use cases, and each archetype tends to prioritize a different combination of them.

	Prioritized use-case examples across four engines
Customer profiling	1 Integration of third party data sources for target audience filtering
	2 Free samples distribution in exchange for customer data
	3 Target high-value prospects by generating rich lookalike models
	4 Retargeting optimization with website browsing history
Content management	5 Personalization and dynamic creative in ads via audience targeting
	6 Occasion/event based marketing
	7 KOL performance optimization by automated KPI monitoring
	8 Targeted offer optimization with behavioral and segment data
	9 Enablement of outbound communication triggers
	10 Pushing personalized content based on changes in customer behavior
	11 Core brand asset management, decommissioning, asset licensing management
	12 Weibo top search management via celebrity & KOL
Precision marketing	13 Product innovation by satisfying unmet needs from "Consumer to Business to Consumer" survey
	14 Submit TA for testing campaigns & measure multi-platform performance
	15 Enablement of next best recommendation
	16 Website/landing page personalization based on customer segmentation
	17 T-mall Uni Marketing based on EC data
	18 Advertising publisher and placement optimization
	19 Dynamic and personalized email execution
	20 Key search words optimization on search & vertical platforms
Customer management	21 360 degree view of customer, propensity scoring and modeling
	22 Word of mouth management (e.g., on product comments and live reviews)
	23 WeChat viral marketing via group management and friends' circle ads
	24 Professional consulting service and customized engagement based on stages
	25 "Interest" to "Purchase" customer journey optimization

Exhibit 3b

There are 25 top 'traffic engine' use cases, and each archetype tends to prioritize a different combination of them.



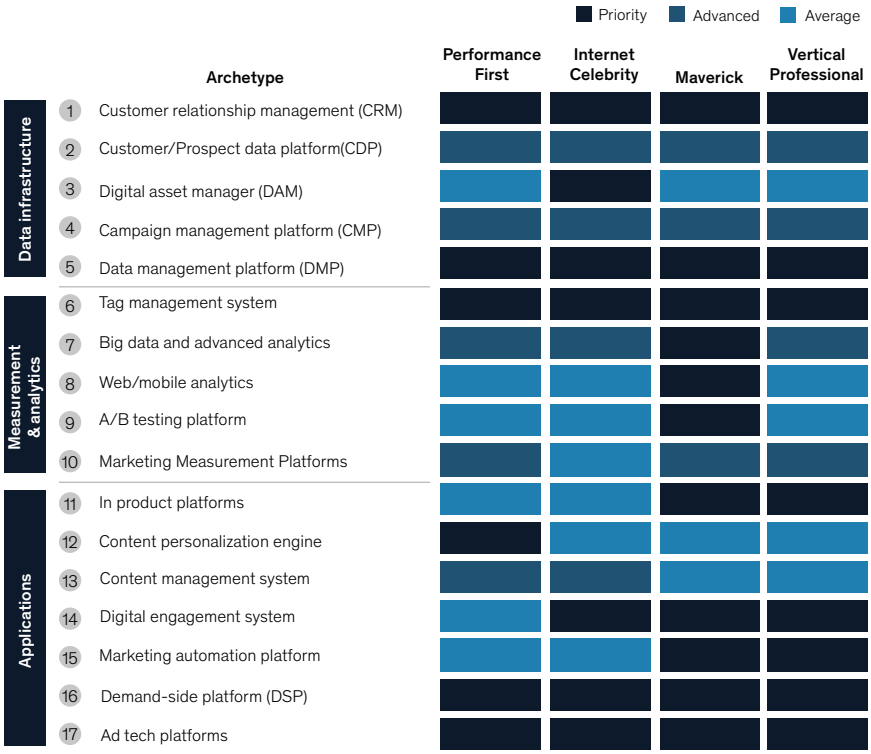
Source: Expert interviews, team discussion

A lean technology and data infrastructure

Building out use cases and developing impactful traffic generation engines requires a broad assortment of tech and data tools and functionalities. Most brands will need 15 to 20 different functionalities across their application, analytics and data infrastructure. Some of these are core capabilities all brands will need, such as customer relationship management (CRM) and a data management platform (DMP). Others, roughly half, should be designed to drive impact and deliver a competitive advantage (Exhibit 4).

Exhibit 4

4 archetypes have common needs in data storage and analytics, with different applications to support its respective use case priorities.



For example, a local upstart beauty brand, taking an Internet Celebrity approach, built a tag management system for the 6,000-plus KOLs and KOCs who promote or feature the company's products on social platforms. The tool identifies and segments these social influencers into hundreds of mini KOL groups according to their location, fan base, age group, and channel, and then does real time performance monitoring, analysis, and adjustment. The company also utilizes a digital engagement system and AI-powered chatbots to improve the efficiency of managing multiple group chats simultaneously. As a result, the company boosted both its click through rate and conversions by 10 to 15 percent.

A sport fashion brand, on the other hand, as a Maverick brand, built market-leading big data and advanced analytics engines, such as a unified customer data platform (CDP) and campaign management platform (CMP), that leverage the customer data it captures on its own shopping, training, and running apps

and on its WeChat group. The company used this data—amounting to 50 percent of its total customer purchasing data—to drive its strong ecommerce growth in 2019.

No brand can develop all their functionalities at once. Instead of a hefty, two-year roadmap, leading brands simplify their IT and data strategy by finding a mixture of quick wins and long-term goals. They drive real impact from a handful of core functionalities that are up and running within a year, then continue to iterate and build upon them to expand into other functionalities over a 2 to 3-year period.

A balanced vendor ecosystem

Whether outsourcing their tech and data capabilities or operating them in-house, brands will need to work with partners across the advertising value-chain and martech ecosystem. In China, no fewer than 5,000 different martech providers have lined up to provide help. So too have the large platforms. In fact, working with Alibaba's Brand Data Bank and Uni Marketing desk, or the Tencent Marketing Solution and DMP, is now so widespread that it's the 'table stakes' in digital marketing.

Leading brands go several steps further to partner with an array of point service providers. They use many off-the-shelf solutions, while also customizing capabilities that are core to the brand's needs. For example, although some leading brands have partnered tightly with Alibaba, they also leverage third-party vendors for dynamic content technology and data lake infrastructure to ensure a rapid marketing technology adoption.

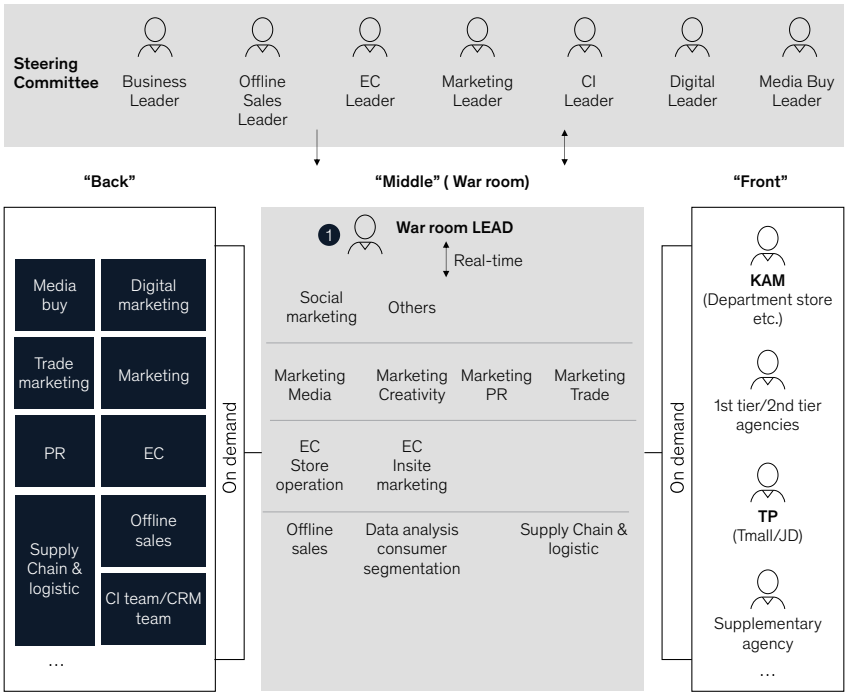
An agile organizational model

China's digital landscape is constantly changing, sometimes with what seems like daily frequency. In such an unpredictable environment, brands need a flexible organizational model that will let them constantly monitor changes and adapt quickly to go after new opportunities. This means hiring not just people experienced in performance marketing, but those who can excel in new roles: a digital marketing leader who sits on the marketing strategy team alongside the marketing leader and brand general manager, a social marketer for social content marketing, a KOL/KOC developer, and a CRM activity designer to reactivate dormant customers.

An agile organizational model also means adopting a new mindset where nothing is ever final. Leading brands have embraced a test and learn attitude and are constantly looking at performance and measurement data to see when and where adjustments are needed. They often start by setting up war rooms where people from different functions and departments come together to collaborate and develop this shift in mindset (Exhibit 5).

Exhibit 5

Use "Digital war room" to improve cross-team collaboration and efficiency to adopt new digital marketing initiatives.



Source: Expert interviews, Team analysis

Getting started

Generating high-quality traffic and impactful digital marketing can be broken down into a three-part journey. The first is prioritization. In this stage, brands conduct a self-diagnosis of strengths, a determination of the size of the opportunity, and the creation of a broad, high-level vision. From there, brands can prioritize their key customer traffic pools and the traffic engine use-case that will drive the biggest impact in the least amount of time.

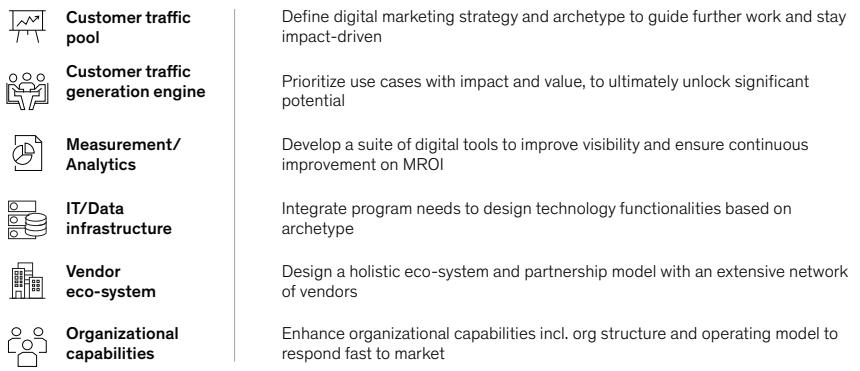
Stage two is about capturing quick wins. This will help build momentum and demonstrate the value of further effort and investment. It entails setting up a war-room, establishing vendor partnerships, building the solution, launching it over several weeks, and then continuously improving it in 1 to 2-week sprints. The goal is real impact within 12 weeks.

After the first use case is up and running and traffic generation is accelerating, brands can step back and plan the full, mid-to-long-term transformation, including the next wave of use cases that will drive real, measurable, and lasting impact on the customer journey and the company's capabilities.

By ensuring a strategic focus, prioritizing use cases based on impact, launching 'quick win' sprints, building an ecosystem and developing partnerships, and—most importantly—building capabilities throughout the organization, companies can generate real impact throughout the Awareness-Interest-Purchase-Loyalty (AIPL) journey (Exhibit 6).

Exhibit 6

Pursuing a total solution for traffic generation.


Customer traffic pool
Define digital marketing strategy and archetype to guide further work and stay impact-driven
Customer traffic generation engine
Prioritize use cases with impact and value, to ultimately unlock significant potential
Measurement/ Analytics
Develop a suite of digital tools to improve visibility and ensure continuous improvement on MROI
IT/Data infrastructure
Integrate program needs to design technology functionalities based on archetype
Vendor eco-system
Design a holistic eco-system and partnership model with an extensive network of vendors
Organizational capabilities
Enhance organizational capabilities incl. org structure and operating model to respond fast to market
Brings real impact through the AIPL journey
Awareness
20~40%+
TA increased
Interest
2-5X
CTR
Purchase
20-30%+
MROI increased
Loyalty
10%+
ARPU increased

Source: Expert interviews, team analysis, Press search

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The authors would like to thank Maggie Wang, Rachel Qiu Jin, Simon Wintels, Tom Beeby, and Yinlian Bai for their contributions to this article.

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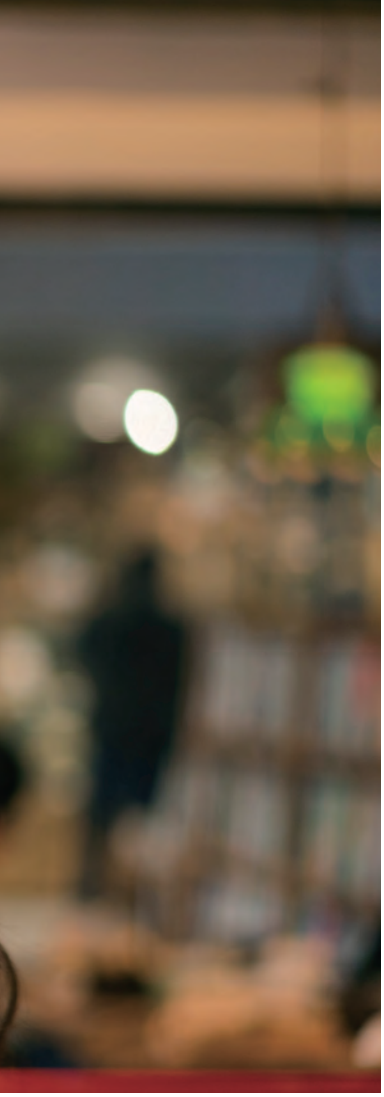
Harnessing the power of social commerce to fuel growth in China

Social commerce has seen triple-digit growth over the past five years in China.

Caleb Balloch, Lambert Bu, Lavonda Li



Social commerce, where social media is the driving force behind sales, is one of the hottest trends in China and a major disrupting force.

Social commerce has seen triple-digit growth over the past five years in China. Brands that have already embraced social commerce are testimony to its potential, with new entrants able to rapidly grow their business and reach new consumers in China's lower-tier cities.

As competition in the sector heats up, brands should move quickly to gain early-mover advantage, and develop a winning social commerce playbook to position them for future growth.

The rise and rise of social apps

The average consumer in China now spends more than seven hours a day on the mobile internet, a figure that increased by a fifth in the aftermath of the COVID-19 crisis. About two-thirds of those seven hours is spent using social or content apps, as users increasingly seek out information from social media, social influencers, and friends in order to make decisions about purchases.

Time spent using social or content apps is now driving 50 percent of shopping interest, and 25 percent of purchases, a marked change from the 2017 figures of 37 percent and 7 percent, respectively (Exhibit 1). And the size of the overall social commerce market is expected to more than double from 2019 levels to reach gross sales of 2.9 trillion renminbi by 2021 (Exhibit 2).

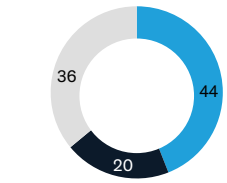
Brands and platforms that are already operating in this space are seeing considerable success: key social commerce platforms such as Pinduoduo and Xingsheng Selected have seen year-on-year growth of 92 percent and 233 percent in their respective number of active monthly users.

Some of the biggest multinational and Chinese fast moving consumers goods (FMCG) brands are selling on such social platforms, while new brand entrants such as TST Tin'Secrets have been able to rapidly grow their businesses from scratch.

Exhibit 1

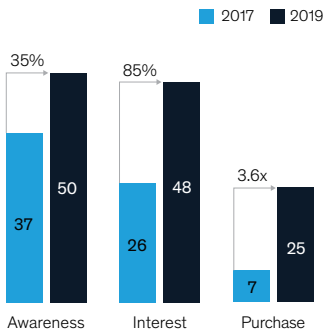
Social media is a core part of consumers' lives

Social & content account for >65% of online time[1], % of China mobile internet monthly online time



- Content App (e.g. iQiyi, online music)
- Social Apps
- Others (e.g. gaming, e-commerce)

Social is enhancing influence on "Purchase", % of respondents



COVID-19 has accelerated this shift

Time spent on mobile internet increased by **20%** from 6.1 hours to **7.3 hours** in early post COVID-19

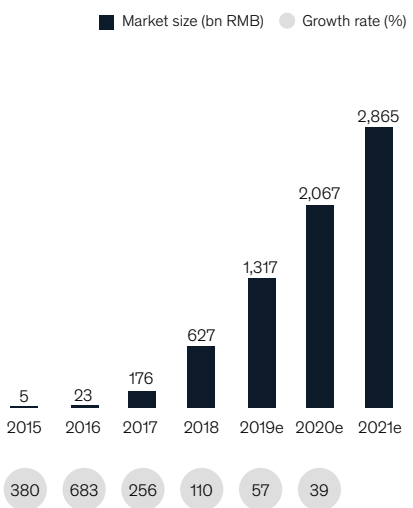
~60% of consumers will continue avoiding crowded offline shopping, and **~36%** will shop through new online channels

[1]QuestMobile TRUTH China Mobile Database Feb. 2020.
Source: Digital consumer Survey 2017, 2019

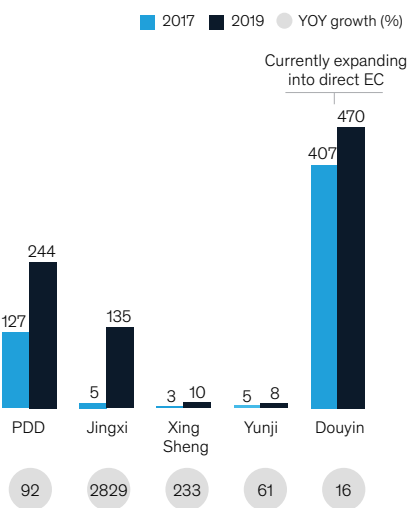
Exhibit 2

Social commerce is growing rapidly with a number of notable platforms emerging quickly

Social commerce overall market size and growth



Social commerce key platform growth, MAU in millions



Source: iReseach, Questmobile Report, Trustdata Report, company press release

This growth comes against a backdrop of stagnating bricks-and-mortar sales, and slowing growth in online sales.

Traditional e-commerce sites such as Alibaba and JD are seeing their growth in e-commerce sales drop to around 20-25 percent, according to McKinsey's China Digital Consumer Trends 2019 report, while the cost of customer acquisition and retention is rising sharply as brands compete in an increasingly saturated market.

The rise of social commerce combined with the slowing growth of conventional e-commerce has sparked disruption across the value chain:

— **Consumer engagement** with brands is becoming more active, with brand equity and loyalty nurtured through social interactions and word of mouth between consumers, rather than between a brand and its consumers.

— **Business models** are becoming more complex with the resurgence of direct-sales where users receive incentives for referring friends into membership programs and converting sales. These business models often require higher sales margins but less marketing spend than traditional business models, and create channel conflicts as a result.

— **Innovation is becoming more collaborative,** as brands work closely with Key Opinion Leaders and Key Opinion Consumers (KOLs and KOCs) to co-develop new products and shape the next wave of trends.

— **Internal operations are becoming more agile,** with cross-functional teams working in fast iterations, testing new ideas, and breaking down silos.

China's five archetypes of social commerce

There are five major archetypes of social commerce in China (Exhibit 3).

— **Social-first commerce**—where KOLs and KOCs are used to direct consumers to emerging on-platform sales and branded stores.

— **E-commerce platform with social marketing**—where KOLs and KOCs are used to direct customers to established branded stores.

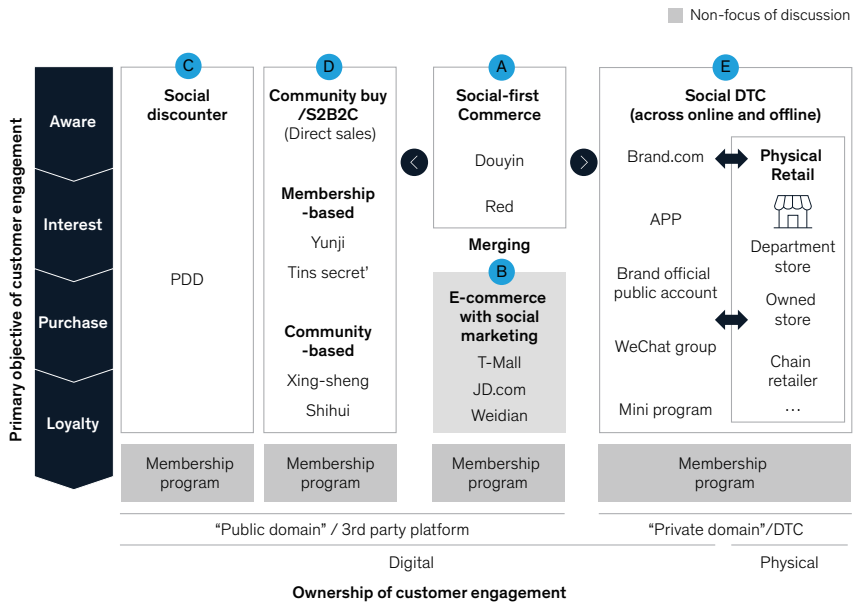
— **Social discounter**—where social sharing of products is incentivized by offering lower prices with every incremental customer.

— **Community buy/S2B2C**—where consumers and small businesses are incentivized to sell to their friends by receiving commission.

— **Social DTC**—where brands and KOLs/KOCs engage directly with consumers in brand-operated WeChat groups and convert them into sales either through the brand's own platform or through WeChat mini programs.

Exhibit 3

Social commerce can be classified into 5 major archetypes



Key typical social plays

- A **Social-first Commerce:** Sell through KOLs/KOCs onto emerging on-platform sales and branded stores
- B **E-commerce platform with social marketing:** Sell through KOLs/KOCs onto established branded stores
- C **Social discounter:** Incentivize sharing by offering lower prices with every incremental customer
- D **Community buy:** Direct sales incentivizing consumers & small businesses with commissions for selling to their friends
- E **Social DTC:** Social engagement catalyzed by brand & KOL/KOC operations in WeChat groups, converted on Mini-program & brand.com

Source: McKinsey analysis

Below we look at each of the emerging archetypes in more depth, namely social-first commerce, social discounter, community buy/S2B2C and social DTC.

Social-first commerce

Food and lifestyle blogger Li Ziqi is an example of a KOL that has effectively deployed social-first commerce. She has become one of China's biggest social media stars by posting artistic videos of traditional life and cooking in Sichuan province's rural areas. Having built an enormous fan base (26 million on Weibo, 39 million on Douyin, and 11 million on YouTube), she now operates an eponymous brand of traditional Chinese packaged food, promotes third-party brand foods, and operates a store on Tmall to sell directly to her followers.

Li Ziqi sold 100 million renminbi of products in 2019, more than three times the year before, with her success demonstrating the power of converting social engagement into commercial results.

This method of social commerce is an effective way of building a customer base, as well as strengthening engagement and building brand loyalty through rich content and interaction.

Social-first content platforms are core to exploiting the opportunity. Most notable among them are Douyin, the hugely successful short-form video platform, and RED, a lifestyle platform where consumers review products and share lifestyle tips. In addition to generating traffic for established e-commerce platforms Taobao and JD, these social-first platforms have launched their own e-commerce sales functions and branded stores, though they are still at an early stage of development and have yet to bring significant brands on board.

Social discounter

Zhihu is an example of a brand which has successfully captured consumers through the social discounter platform Pinduoduo. By offering a price that is typically less than 30 percent of its peers to consumers who can gather enough of their friends to buy the product together, Zhihu has grown to become a top 4 tissue brand in China within just two years.

Beauty brand KanS has enjoyed similar success, tapping into the customer base of lower-tier cities and seeing year-on-year growth of roughly 100 percent in online sales. By discounting as much as 40 percent for group purchases on Pinduoduo, it has been able to clear slow-moving or near-expired inventory.

One of the key strengths of social discounter platforms is being able to target price-sensitive customers with value-for-money propositions. Although much of the attention of China's new generation of consumers has focused on urban centers such as Beijing and Shanghai, lower-tier cities such as Mianyang, Yancheng, and Zigong are increasingly important thanks to their large pools of consumers with significant levels of disposable income and a keen appetite for online deals.

Community buy/S2B2C

Platforms Xinsheng Selected and Yunji, and skincare products seller TST Tin'Secret, are examples of the fast-emerging community buy/S2B2C archetype. The archetype is characterized by a digital adaptation of the direct sales model, where individuals receive referral bonuses and commissions for sales made to their friends.

TST Tin'Secret is a beauty brand which has harnessed the 'WeShang' social-direct business model to grow sales to an excess of 30 billion renminbi in 2020, gaining six million members after just seven years in operation, and enjoying a compound annual growth rate of 150 percent since 2017. Individuals are paid a commission of between 15 and 32 percent for referrals within their social network, and it now has several notable celebrities within its direct-sales ranks. It is currently expanding from an own-brand direct-sales model to a lifestyle membership-based community model.

Community O2O and S2B2C platforms—although still fragmented—saw a resurgence during the COVID-19 lockdown, especially for high-frequency purchases such as fresh produce. In such models, brands sell through a platform which incentivizes group leaders to sell to their friends and connections. In the case of S2B2C, such as membership-based Yunji which sells select value-for-money products, these platforms and group leaders exist entirely online. In the case of community O2O, such as Xinsheng Selected's platform for everyday goods, group leaders are typically small store owners at the center of offline residential communities. This allows brands and platforms to deliver merchandise in bulk directly to small store owners, who further distribute merchandise to a broader customer base. This helps reduce logistics costs significantly, a key barrier for online sales of smaller-ticket items such as fresh produce.

The community-buy platforms' reliance on consumer and individual sales incentives to drive growth is fundamentally different from 'traditional' e-commerce. Many brands have been playing with shifting brand-driven marketing spend to consumer sales incentives. Several brands have even launched new independent product lines and brands to take full advantage of the opportunity without cannibalizing traditional channel sales.

Social DTC

Beauty brand Perfect Diary exemplifies the potential of social DTC, becoming an emerging leader in cosmetics after just three years. From a small base, it achieved gross sales of more than 3 billion renminbi in 2019, growing 5x over 2018. Almost all of its sales are online. And the social DTC operations of WeChat groups and WeChat mini-programs are central to managing its consumer base, capturing roughly a quarter of sales.

Its growth has been driven in part by the success of its social DTC operations. Members are pulled into WeChat groups where they engage actively with brand-managed virtual avatars, lifestyle content, and beauty tips. A 6,000-strong KOL and KOC network drives engagement both in the public domain as well as within its private domain social DTC. Perfect Diary's strong social DTC operations has allowed it to own consumer traffic higher in the sales funnel, at the acquisition and interest levels, providing it with more natural repeat traffic, as well as helping it build a strong bargaining position with Tmall and Taobao for resource exchange.

Capturing the opportunity

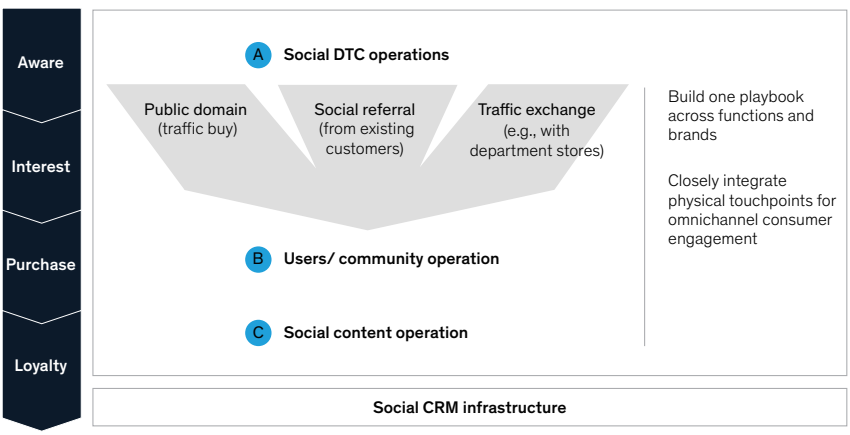
Although many brands have entered the social commerce arena, their spontaneous and scattered approach has not always led to success.

Some brands have been unable to generate substantial, high-quality traffic, or are generating low-sales and conversion rates in their social commerce stores. Others have struggled with poor channel integration, siloed functions, limited ownership of consumer relationships, and inconsistent messaging within groups or content.

Building successful social commerce at scale requires a new playbook. For example, building a winning social DTC playbook requires four new or updated capabilities: user acquisition, user/community operations, social content operations, and social and CRM infrastructure (Exhibit 4).

Exhibit 4

Social DTC target 'playbook'–acquire & operate users/ community with social content, and integrate with physical touchpoints



Source: McKinsey analysis

User acquisition: Users come from a combination of three sources: the public domain (by purchasing traffic), social referral (from existing customers) or traffic exchange (from e-commerce platforms or department stores, for example). Perfect Diary takes people on this consumer journey from the public to private domain, attracting traffic through rich social content, referring them to WeChat groups to build engagement and loyalty, and facilitating conversions in either its WeChat mini-programs or Tmall flagship stores. Their journey is simple, and consumers are always more accessible from either the private WeChat groups or conversion in their online stores.

User/community operations: The community then needs to be carefully managed to ensure that members stay active. A leading sportswear retailer, for example, has store managers act as 'mini-CEO's to manage their community as well as their stores. They recruit three types of KOLs/KOCs to elevate community engagement: brand ambassadors offering sports activities, internet celebrities to endorse and model sportswear and promote it on social channels, and community partners to offer advice in-store or at sports venues. Other brands may opt to employ KOC (key opinion consumer)—or even avatars—to drive the conversation. In addition, consumers need to be carefully segmented to ensure the best possible fit, and content then thoughtfully developed to maximize its potential.

Social content operations: A steady flow of strong content needs to be developed and closely monitored to take advantage of the viral nature of social media. Content should come from a mix of brand-made, user-generated, and third-party sources. Lifestyle content is key, as too much content which overtly promotes products risks becoming tedious. Perfect Diary, for example, posts appealing, relevant content—not just the expected beauty tips but also general lifestyle content about food or leisure. While the content should reflect the essence of the brand—by focusing on carefree people enjoying an active lifestyle, for example—it doesn't necessarily need to mention the brand by name. Once again, the use of KOLs/KOCs is critical, and their use should be maximized with strategies to build up to, and follow up on, their input.

Social and CRM infrastructure: Underscoring all of this is the need for the correct infrastructure to manage these relationships. This involves migrating to WeChat at work, for example, running mini-programs to launch DTC e-commerce, and integrating existing systems with department stores. CRM systems and other tools to manage the customer relationship should also be integrated across all channels.

Other archetypes of social commerce will require their own playbooks, each adapted to the specifics of that model. For example, the community buy model often uses a differentiated portfolio strategy, to ensure the platforms maintain a sufficient margin and sellers minimize the risk of cross-channel leakage.

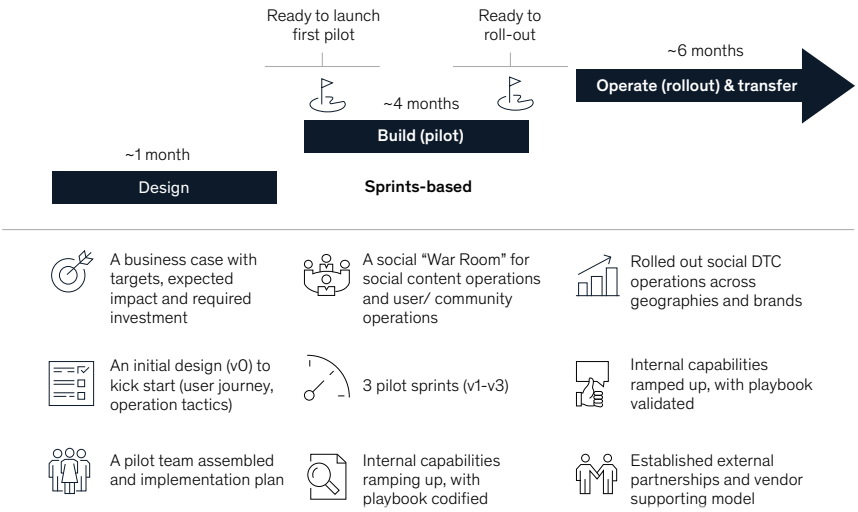
A roadmap for success

With social commerce continuing to evolve, drawing up lengthy strategies or looking for an established model to replicate may not be the best approach.

Instead, brands should place a strong emphasis on testing and quickly adapting pilots in sprints, before codifying a playbook and rolling out operations at scale. Successful brands have been able to build new social commerce businesses within 6 months.

Exhibit 5

How brands ramp up social DTC business over 6+ months


Ready to launch first pilot
Ready to roll-out
~6 months
Operate (rollout) & transfer
~4 months
Build (pilot)
~1 month
Design
Sprints-based
A business case with targets, expected impact and required investment
A social "War Room" for social content operations and user/ community operations
Rolled out social DTC operations across geographies and brands
An initial design (v0) to kick start (user journey, operation tactics)
3 pilot sprints (v1-v3)
Internal capabilities ramped up, with playbook validated
A pilot team assembled and implementation plan
Internal capabilities ramping up, with playbook codified
Established external partnerships and vendor supporting model

Source: McKinsey analysis

A social 'war room'—where agile teams respond to daily challenges and trial different methods before settling on the best approach—is a key part of the pilot stage (Exhibit 5). These learnings are then consolidated before the brand scales up further and expands its operations to other products and regions.

Continual change

In order to harness the power of social commerce, brands will need to be agile; developing a new playbook and acting on data to scale up. In order to overcome their own internal hurdles, brands will also need to be prepared to disrupt their existing norms and business models.

For brands that embrace rapid change, social commerce presents a game-changing opportunity for penetration and transformational growth.

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The authors would like to thank Autumn Qiu, Grace Cheng, Lei Xu, Roy Lee, Ray Liu and Yin Zhu for their contributions to this article.

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How digital B2B changes the game for consumer goods companies in China

Digital disruptors are gaining ground in China's retail market by selling directly to small stores. Brands must decide how best to partner with them.

Cherry Chen, Felix Poh, Jia Zhou, Lei Xu

The context of China's retail landscape

Fragmented trade is an important part of China's vast and unique grocery retail landscape. It consists of traditional "mom & pop" stores, as well as independently operated convenience stores and small supermarkets. The traditional "mom & pop" stores are conservatively estimated to exceed 3.4 million[1], making up one-third of China's overall offline grocery retail sales.

Convenience stores are the fastest-growing store type, while small supermarkets are also large in number. These stores have deeper local coverage and more loyal consumer relationships since they are deeply rooted in their local communities and located closer to customers. This is in contrast to larger formats such as hypermarkets as well as B2C e-commerce platforms.

However, a major problem with these small stores is that they are dispersed across China. This requires a complex distributor system and many are not well served at present. It is also difficult to guarantee supply efficiency or quality. Therefore, digital B2B platforms have emerged, leveraging the existing infrastructure built by B2C e-commerce players.

A number of disruptors have emerged in China's B2B space, in both the retail and hospitality sectors.

— Alibaba's LST and JD's XTL are leading players in the digital B2B space, having built on the success of their B2C eCommerce platforms. They connect traditional stores directly with suppliers. As of September 2020, LST serves 1.5 million stores and has opened its digital store operation system to store owners. It aims to help as many stores as possible reach a sales target of 10,000 renminbi per day. The stores are also empowered by data analytics for better assortment and merchandising. From the consumer goods companies' perspective, B2B players provide access to the sizeable network of fragmented retail stores. This gives brands the ability to promote sales without being highly dependent on intermediaries and wholesale distribution systems.

[1] Euromonitor

— Meicai and Yijiupi focus on specific channels and categories. Alcoholic beverage focused player Yijiupi, whose investors include Meituan and Tencent, is reaching a significant number of fragmented tobacco and alcohol stores. Meicai provides supply chain solutions for small restaurants that need to purchase fresh food and drinks.

These players aim to replicate the proven success of online B2C retail. By disrupting the traditional tiered distribution system, they aim to improve transparency and efficiency. Consumer goods companies should consider these potential changes in the market's structure and act accordingly.

The impact on stakeholders along the value chain

The emergence of digital B2B is likely to address key pain points in the market, providing a unique value proposition for store owners, logistics providers, and brands.

First of all, it is easy for store owners to embrace digital B2B due to the high internet penetration in China (mobile internet in particular), as well as the strong take-up of digital tools among the general population. For example, the mobile payment penetration rate is as high as 81 percent among smartphone users. Also, digital B2B offers a one-stop service platform which is far more convenient than interacting with sales representatives across multiple manufacturers and distributors.

Secondly, distributors and logistics providers can also benefit from digital B2B in the long run, as these platforms allow for more centralized procurement, thereby increasing distribution efficiencies and loading rates when compared with traditional practices.

Lastly, consumer goods companies can leverage digital B2B to increase their influence at the point of sale, boost channel coverage, and enable better sales execution. By harnessing these digital tools, brands will be able to undertake precision marketing, promote new product launches more effectively, and accelerate distribution to lower-tier cities and rural areas in particular.

Of course, there are still some challenges in the development of digital B2B platforms:

— Despite the relatively inefficient distribution systems of traditional small stores, some services such as payment advances and the logistics for bulkier goods with a lower margin are not easily replaced.

— Building up local store relationships is a lengthy process, and establishing new partnerships requires a great deal of time and manpower.

— There is fierce competition within the digital B2B market, and some players have already exited the market.

Smaller players have found it difficult to scale up and ensure profitability in the digital B2B space, leading them to withdraw. Going forward, only a handful of players with strong capabilities, deep pockets, and a unique value proposition will end up reshaping China's retail landscape in favor of digital B2B.

How should brands work with digital B2B players?

To maximize the value from digital B2B, there are many questions for consumer goods companies to consider: Should they cooperate with the digital B2B players, and if so, how? And what are the key benefits of such partnerships? What should they watch out for?

Brands must first assess their strengths and weaknesses in the following two areas.

1. Types of Goods

Are the products lighter goods with a higher gross margin, for example foreign liquors, high-end packaged foods (e.g. imported snacks and premium chocolate), personal care products and cosmetics? Or are they bulkier goods with a lower gross margin, such as soft drinks or basic laundry powder?

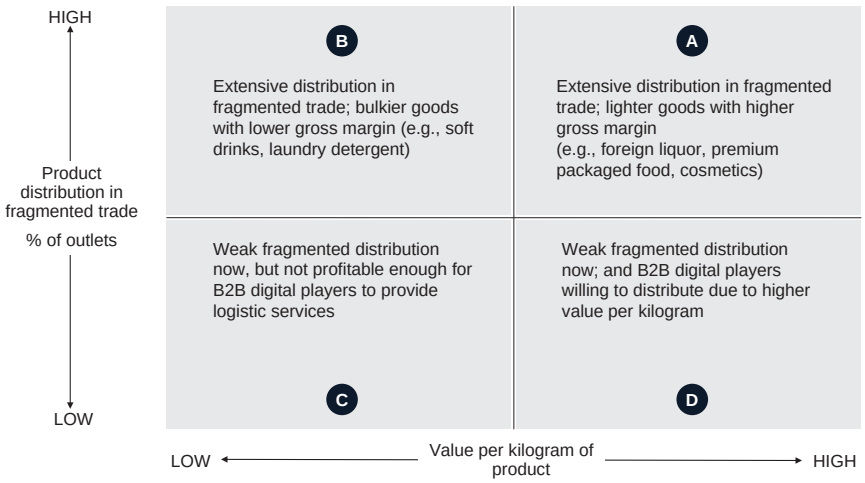
It is not very profitable for B2B players to provide logistics in the short term for bulkier goods with lower margins. Rather than providing logistics at a relatively high cost, digital B2B players may prefer to act as marketplace platforms that provide customer coverage and data services. But the distribution of goods is still a problem.

2. Distribution channels

How strong are the brands' existing distribution capabilities in fragmented trade? This will directly impact the strength of their negotiating position, and the benefits digital B2B players want from partnerships.

Exhibit

Depending on category attributes and companies' own distribution capability, the value proposition of B2B disruptors is different


HIGH
Product distribution in fragmented trade
% of outlets
LOW
B
Extensive distribution in fragmented trade; bulkier goods with lower gross margin (e.g., soft drinks, laundry detergent)
A
Extensive distribution in fragmented trade; lighter goods with higher gross margin (e.g., foreign liquor, premium packaged food, cosmetics)
Weak fragmented distribution now, but not profitable enough for B2B digital players to provide logistic services
C
Weak fragmented distribution now; and B2B digital players willing to distribute due to higher value per kilogram
D
LOW
Value per kilogram of product
HIGH

Source: McKinsey analysis

The position of brands on the exhibit above will determine the returns they can expect from working with digital B2B players.

Quadrant A: Brands with stronger distribution capabilities for products with lighter goods and a higher gross margin

The direct benefits of partnering with digital B2B players are limited for companies in quadrant A. The main benefits are the availability of customer data, precision marketing, and the rapid distribution of new products. When drawing up cooperation strategies, brands should focus on protecting existing channels and minimizing cross-channel trade, while negotiating reasonable platform fees to ensure profit margins.

Quadrant B: Brands with stronger distribution capabilities for bulkier products with a lower gross margin

Digital B2B players are unlikely to enter as logistics providers in the short term. In the long term, however, they are more likely to begin transporting heavier goods alongside other products once last-mile logistics capacity has been established, thereby lowering costs. Organizations in quadrant B should therefore establish favorable terms and conditions in partnerships. They should even consider becoming the distribution partner of choice for these platforms for bulkier, lower margin products. By establishing a competitive advantage in this area now, they may be able to gain the upper hand in future negotiations.

Quadrants C&D: Brands with weaker market influence and distribution capabilities

For companies with limited distribution networks, the main benefits of cooperating with digital B2B players is quite clear—to quickly increase outlet coverage, actively penetrate lower-tier markets, and tap into a new base of customers. This is more efficient than the traditional method of acquiring new customers by sending sales reps to visit individual stores.

Brands selling lighter goods (quadrant D) can piggyback on the logistics capabilities of digital B2B players for effective distribution, even though that will also lead to a heavy reliance on their B2B digital partners. These brands should therefore try to achieve better ownership of customer data and relationships in partnerships.

For companies selling bulkier goods (quadrant C), digital B2B players are unlikely to provide the necessary logistics. This means that, in the short term, distribution and delivery still have to be completed by consumer goods companies themselves, or via distributors. This also provides an opportunity for brands to establish independent distribution systems.

Some brands are also considering establishing their own digital B2B platforms or partnering with other companies. However, due to the diversified needs of small stores and the fragmentation of the Chinese market, an alliance of at least five or six large companies is likely to be needed to reach economies of scale and satisfy the basic needs of small shops. Operationally, it is very difficult to make such an alliance work effectively.

Fostering a healthy brand/digital B2B platform collaboration

Commercial terms should also be carefully defined before entering into a partnership. Some of the most frequent issues are highlighted below:

- **Boundary rules:** Is the partnership limited to a specific geographical area? Should there be explicit exclusive requirements for some areas? Will brands gain access to stores in new areas covered by the digital B2B platforms? And will B2B digital players have full access to the existing distribution network of brands?
- **Product portfolio:** Should there be differentiated product portfolios for stores with different channel models? For example, brands tend to retain part of their product portfolio for high-priority stores, while digital B2B players may require exclusive offerings of certain products, or even platform-customized products.
- **Pricing and promotion:** It is important to establish who has authority over pricing and promotions. Brands usually want to keep a tight grip on this, while digital B2B platforms usually prefer more flexibility.

— **Data:** How much data should digital B2B players share with partner brands? Should it cover all sales, data, pricing and store information, for example?

— **Roles and responsibilities of both parties:** Which party is in charge of order placement, logistics, sales, promotion, execution, and payment? While this is often straightforward for stores fully managed by one of the two parties, it is more complicated if stores are already covered by both parties.

— **Platform fees:** Brands should have a rough expectation of acceptable platform fees, split into commission fees and marketing expenses. It may be beneficial for the consumer goods companies to negotiate a reduction or exemption for platform commission fees, while digital B2B players may choose to set a floor for marketing expenses.

It is only by clarifying all these commercial terms—with the bottom line and strategic goals in mind—that a successful partnership can be drawn up.

It is also a good idea to pilot the partnership. Even with careful preparation and planning, problems can still emerge during implementation. Brands should start with small-scale pilots and iterate based on feedback. When the partnership encounters problems—channel conflicts, price fluctuations, gaps in the product portfolio, commission disputes, and so on—brands should stay positive and make real-time adjustments, with a view to developing a long-lasting and large-scale win-win partnership.

Over the longer term, brands should also consider the role of digital B2B partners in the entire sales system. This will include monitoring the impact on, and needs of, the sales team, including frontline sales reps, as well as issues relating to process, organization, or technical support. This will help brands better plan and implement the transformation gradually.

The COVID-19 factor

The overall logic of brand-digital B2B partnerships will still be effective post-COVID-19, taking into account the following factors.

1. The profit margins of small shops may be squeezed, as some consumers continue online shopping habits established during the pandemic. Small shops are therefore likely to be especially price-sensitive. During the pandemic, many “mom & pop” stores suffered a sharp drop in footfall and sales, with the most vulnerable forced to close.
2. It may be more difficult for digital B2B players to secure funding. Their own results may well be lower than expected. And the wider economic environment may also make investors more cautious.

3. Consumer goods manufacturers may shift channel focus. A series of new sales channels came to the fore during the pandemic, including live streaming, social commerce, and private domain marketing. These new opportunities might weaken the focus on traditional channels to a certain extent.

Conclusion

In summary, the digital B2B space has significant potential and will, over time, change the structure of fragmented trade. This will eventually make the whole retail ecosystem more efficient and effective.

Brands desire effective partnerships with B2B digital players. To enable this, it is essential for brands to analyze their own product categories and assess their distribution capabilities to make sure such partnerships are clearly thought through and defined. By seizing these new opportunities, brands will strengthen their management of retailers and increase their reach to target consumer groups. This will ultimately help them achieve greater profit margins and improve their own market position.

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The authors wish to thank Dymfke Kuijpers, Kay Tu, Lin Lin, Shuangle Chen, and Wei Wang for their contributions to this article.

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Hitting top speed: Finding new pockets of growth

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China's Gen Z are coming of age: Here's what marketers need to know

Gen Z represent the next engine of domestic consumption growth.

Jia Zhou, Felix Poh, Cherie Zhang, Daniel Zipser

Officially defined globally as the cohort of people who were born between 1996 and 2010, Gen Z make up about 15 percent of China's population and represent the next engine of domestic consumption growth. Understanding Gen Z is paramount for any consumer company that wants to play a part in China's ongoing economic growth story.

China's Gen Z spent their childhoods during the fastest sustained expansion of a major economy in history, and are consequently used to rapid improvements in their standard of living. They are also China's first generation of digital natives, and as such are instinctively familiar with technology as a form of communication and entertainment, and as an enabler of commerce.

With an eye to helping consumer brands understand how this unique background sets China's Gen Z apart from older generations at home and their peers in other markets globally, McKinsey conducted a survey of nearly 3,000 consumers in China, aged 18-54, alongside our global Gen Z research efforts in United States, Australia, Indonesia, South Korea, and Japan.[1] Based on these investigations, we have identified six key trends that define China's Gen Z as a unique cohort of consumers.

[1] Consent laws restrict the ability to survey respondents under the age of 16 in Asia-Pacific countries, and under the age of 18 in China and the US. Therefore, we surveyed respondents aged 16-23 in Asia-Pacific and 18-23 in China and the US.

Consensus ages of generations in 2020

Gen Z: 10-23

Millennials: 24-38

Gen X: 39-54

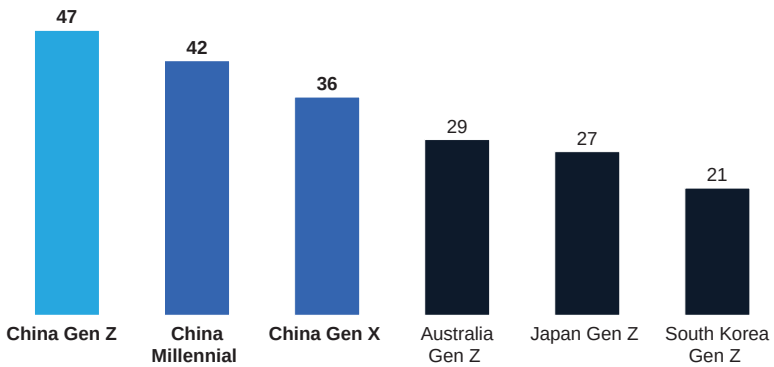
Trend 1: China's Gen Z are optimistic, impulsive, and tend to outspend their budget

In all the countries we surveyed, younger consumers said they are more likely to "buy products on the go". Chinese consumers are more impulsive than their peers in other countries; even Gen X (aged 39-54) shoppers in China indicate they are more spontaneous than Gen Z consumers elsewhere. China's Gen Z are the most spontaneous of all, with 47 percent telling us that they buy products on the go, five percentage points higher than for Chinese Millennials (aged 24-38) and more than 10 percentage points higher than for China's Gen X (Exhibit 1).

Exhibit 1

China's Gen Z are most likely to buy products spontaneously

% of respondents who strongly agree or agree that they "buy products on the go"



Source: 2019 Gen-Z Survey (N = 2,947 in China, N = 3,311 in Australia, N = 2,966 in Japan, and N = 2,482 in South Korea)

This behavior is driven in part by robust confidence in future earnings: 78 percent of Chinese Gen Z respondents said they believe they will earn more, or much more, in the future. This combination of impulsiveness and optimism also leads 36 percent of our survey sample to overspend their budget.

In fact, China's Gen Z refer to themselves as "the moonlight clan" in reference to their propensity to spend their entire monthly salary over the course of a single lunar cycle, effectively living paycheck to paycheck. According to our research, they are also relatively more comfortable owing money; only 21 percent stated they would be relieved if they could pay off all their debts, compared with 28 percent of Chinese Millennials. In China, even university students with no credit records have access to financial products that enable them to make purchases

they would not otherwise be able to afford. These include Ant Financial's Huabei (literally meaning "just spend") virtual credit card, which draws upon consumers aged below 25 for a quarter of its user base, and JD.com's Baitiao card, which enables customers to buy on the spot and pay later, as well as a multitude of other financial products. Gen Z consumers in the US are similarly inclined to spend big on consumer products, while their outlay on luxury apparel and accessories even surpasses that of Millennial shoppers with higher incomes.

Trend 2: Desire for 'unique' products and services

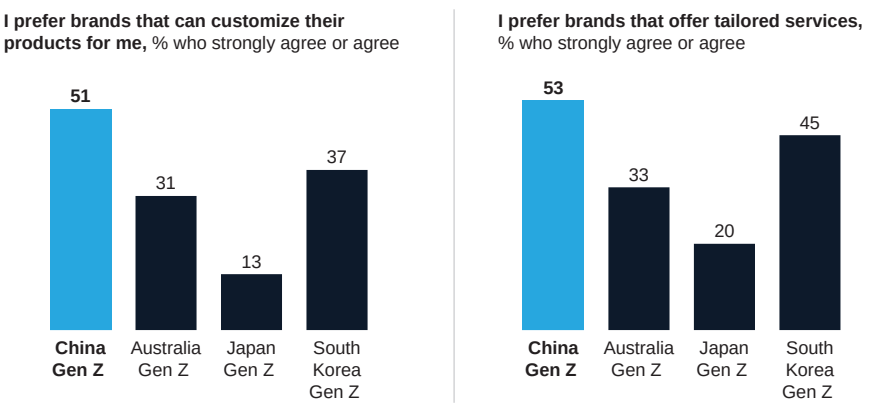
More than half (51 percent) of China's Gen Z consumers prefer brands that offer customized products, while 53 percent opt for brands that provide tailored services. This preference for uniqueness is much more pronounced in China than Australia, Japan, or South Korea (Exhibit 2).

In a spirit of experimentation, brands like YSL have responded by launching 'unique' lipsticks that allow consumers to engrave personal messages onto the case, tapping into China's unique gift-giving culture at the same time. China's Gen Z show their appreciation for such customized products but their willingness to pay a premium is still uncertain. Therefore, these early efforts have yet to make much impact on brands' topline.

Exhibit 2

Gen Z across markets increasingly demand personalization of products and services

% who strongly agree or agree



Source: 2019 Gen-Z Survey (N = 2,947 in China, N = 3,311 in Australia, N = 2,966 in Japan, and N = 2,482 in South Korea)

Trend 3: China's Gen Z are relatively more loyal to brands

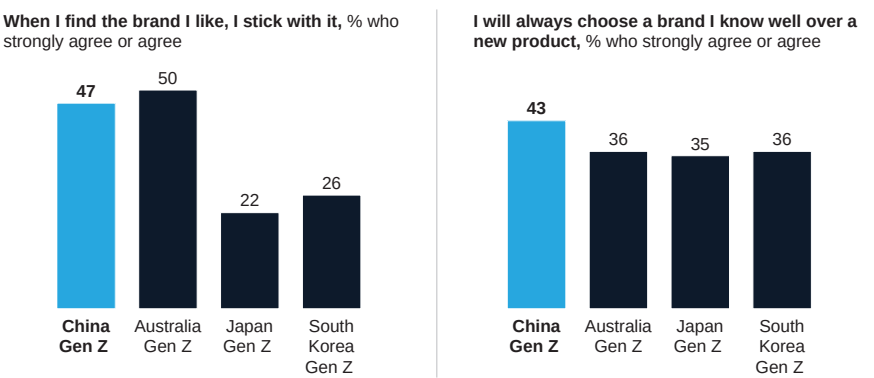
Once engaged, China's Gen Z are also more brand loyal : 47 percent agreed that they stick with brands they like, while 43 percent said they will always choose a brand they know over a new one (Exhibit 3). China's Gen Z are also more loyal than their peers in other countries, especially compared with South Korea and Japan's Gen Z. There is also evidence showing Gen Z in China are even more brand loyal than their older peers.

Successful brands increasingly leverage customer relationship management on social apps to keep customers engaged and retained. For example, WeChat mini programs—apps within WeChat that do not have to be downloaded separately—offer users an array of value-added services, including exclusive access to online events, priority restaurant bookings, and mobile games, all of which help to foster brand loyalty.

Exhibit 3

Once engaged, Gen Z in China and Australia have higher levels of brand affinity than Japan and South Korea

% who strongly agree or agree



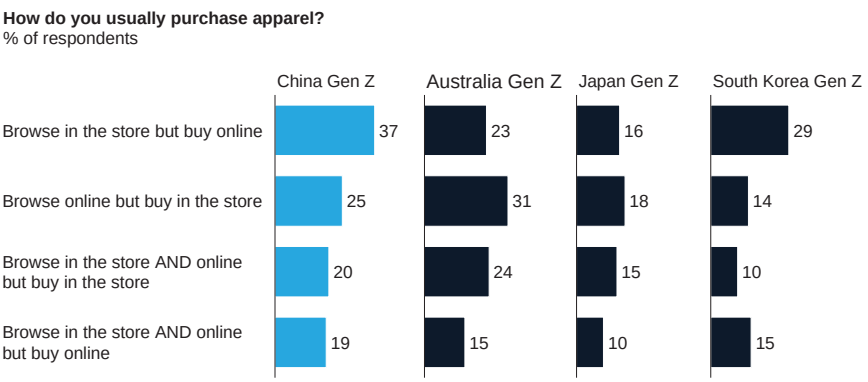
Source: 2019 Gen-Z Survey (N = 2,947 in China, N = 3,311 in Australia, N = 2,966 in Japan, and N = 2,482 in South Korea)

Trend 4: Omnichannel shopping is on the rise

Gen Z consumers in China are more used to omnichannel shopping experiences compared to Gen Z in other countries. Taking apparel as an example, almost 40 percent of Gen Z consumers in China stated they would browse in-store but shop online while only about 15-30 percent of Gen Z in other countries stated they would do so. However, less than 20 percent of China's Gen Z consumers would leverage both online and offline channels to browse apparel. This indicates online and offline channels play different roles in China Gen Z's omnichannel experience (Exhibit 4). In response to this demand for an omnichannel consumer experience, several brands that were initially successful as online-only stores have expanded offline. One example is Chinese snack brand Three Squirrels, which was sold exclusively online for four years before opening its first offline experience store in 2016, achieving fast growth both online and offline.

Exhibit 4

Online is an important channel for Gen Z in China



Source: 2019 Gen Z Survey (N=750 in China)

Trend 5: Gen Z gravitate towards individual merchants on ecommerce platforms due to greater transparency and more quality assurance

Gen Z consumers in China embrace online ecommerce sites that allow peer-to-peer transactions such as Taobao and second-hand marketplace Xianyu to a greater extent than their elders. Our research shows that 43 percent favor these platforms, while the same is true for only 38 percent of Millennials, and 35 percent of Gen X. However, the preference does not extend to individual sellers on other social media platforms (e.g. Weishang) at a similar level of appreciation, potentially because of greater transparency and more quality assurance on Taobao and Xianyu.

Trend 6: Word-of-mouth–the online version–is most influential when it comes to purchase decisions

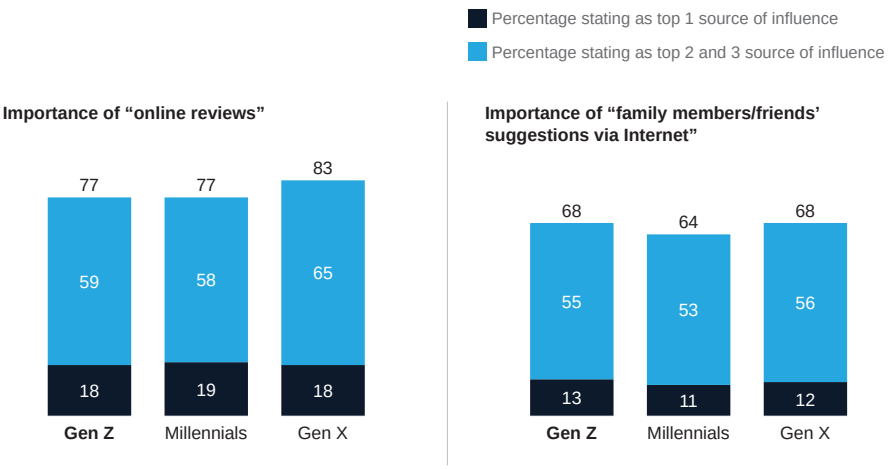
Online reviews, for example product experience write ups on Taobao, Tmall, or RED, as well as the opinions of friends and family on social media, remain powerful sources of influence across the generations in China. More than three-quarters of all generations surveyed said online reviews were among the top three sources of influence when making a purchase decision (Exhibit 5).

Gen Z look to other sources for product recommendations. Fifty-one percent of Gen Z consumers say that official social media accounts of consumer brands are one of their top three sources of influence, while 44 percent count bloggers and online influencers among their top three sources of influence. Gen Z value these sources of information more than Millennials and Gen X. Key opinion leaders (KOLs) who resonate with Gen Z are driving this trend, such as Li Jiaqi, whose forthright opinions can make or break a beauty brand or product, and online sales superstar Weiya, whose interactive livestreams on Taobao have helped sell billions of RMB of products. Apps such as Dianping and Meituan that offer reviews, discussion forums, and group buying options are also popular among young Chinese consumers.

On the other hand, traditional word-of-mouth, or listening to friends and family offline, is waning in importance as a source of influence among young people; only 43 percent of our Gen Z respondents put this category in their top three sources of influence, versus 69 percent for Gen X (Exhibit 6).

Exhibit 5

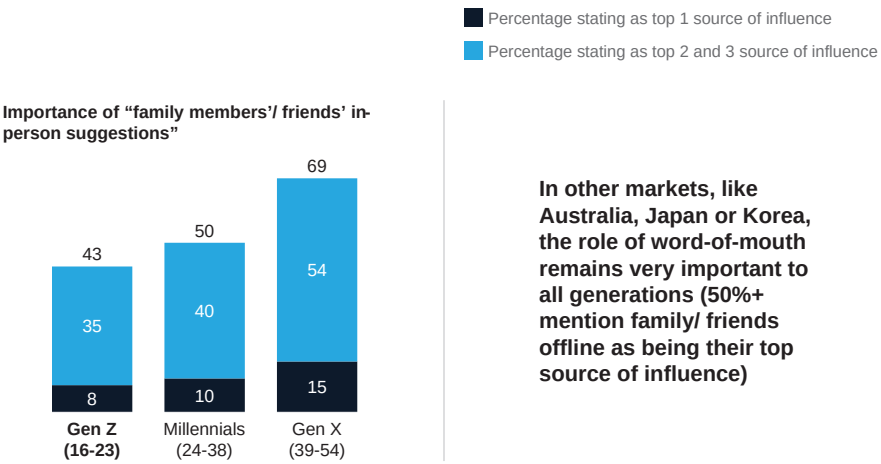
For China's Gen Z, word-of-mouth remains powerful but has evolved to mean online reviews and friends/family on social media



Source: 2019 Gen-Z China Survey (N = 2,947 in China)

Exhibit 6

Traditional, offline word-of-mouth is losing influence among China's Gen Z



In other markets, like Australia, Japan or Korea, the role of word-of-mouth remains very important to all generations (50%+ mention family/ friends offline as being their top source of influence)

Source: 2019 Gen-Z Survey (N = 2,947 in China)

In the US, social media is most influential for 39 percent of Gen Z consumers when deciding to recommend a product or brand, while online reviews and blogs is top choice for 26 percent. Friends and family offline still have most sway for 15 percent, and just 10 percent are primarily guided by influencers.

Implications for brands seeking to resonate with Gen Z

Brands seeking to tap into China's evolving consumption growth story must pay attention to the factors shaping opinion and behavior among Gen Z. Based on our research, brands should consider taking the following steps to resonate with China's new wave of consumers:

1. **Invest in data to drive a deeper understanding of Chinese consumers and develop unique product and service offerings:** China's Gen Z are a unique cohort that demand a differentiated approach. This starts with developing data-driven insights into their shopping pain points, consumption behavior, and expectations for brands. Although this is still an emerging trend that hasn't really impacted topline yet, brands should continue their experiments. One option could be partnering with one of an increasing number of companies providing data-driven insights into China's consumer market, before launching personalized products and services based on the results.
2. **Tailor brand proposition and build loyalty:** Brands must establish a unique proposition that appeals to their target segment, and support this with personalized messaging and services in order to build and retain consumer loyalty.
3. **Double down on both online and offline channels (new social media formats in particular) to ensure a consistent omnichannel experience:** Gen Z increasingly research purchases and complete transactions online so the onus is on brands to provide an inspirational omnichannel customer experience that is consistent and seamless across online and offline touchpoints. Leveraging digital platforms such as WeChat, RED and Tik Tok to establish an end-to-end marketing strategy is necessary to connect with Gen Z, while teaming up with ecommerce players such as JD.com and Tmall is advisable for brands seeking to maximize sales potential. This is true even for luxury brands that are highly protective of their image; Chanel and Estée Lauder both host official brand stores on Tmall. Brands should also continue to offer great offline experiences especially on service, testing and face-to-face social engagement activities.

4. **Identify and partner with the right influencers:** Finding a set of opinion leaders that embody the right brand values, and who can reliably connect with target audiences through user-generated content, is critical. Dedicated agencies can help accelerate this task. For example, Chanel partnered with Instar Model Management to establish a discrete network of micro-influencers, while also partnering with mega stars like the model Liu Wen.
5. **Adjust positioning to resonate with attitudes to technology:** Our research suggests data protection is more important to China's Gen Z than their older peers. Brands should be transparent about how they handle consumer data, and the measures they take to protect it, in order to gain their trust.

Our research presents China's Gen Z as a unique group of consumers who deserve more than a "one-size-fits-all approach." As established elsewhere in this special edition report, the COVID-19 crisis has accelerated existing trends, including digitization, and demand for healthier products and lifestyles. The pandemic has also prompted young consumers to be more prudent, heightening competitive intensity and making it all the more imperative for brands to understand what drives young shoppers in China's fast-growing consumer market.

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The authors wish to thank Aimee Kim, Naomi Yamakawa, Thomas Rüdiger Smith, Resil Das, Cynthia Luan, and Yinlian Bai for their contributions to this article.

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The art of revenue growth management for consumer packaged goods players in China

COVID-19 has put high-quality and crisis-resilient development at the top of consumer companies' agendas. Revenue growth management can help them get there.

Cherry Chen, Daniel Hui, Felix Poh, Kay Tu, Stefano Zerbi, Jia Zhou

In recent decades, the rapid growth of China's economy has led to an explosion in consumption. In the subsequent golden age for the country's fast moving consumer goods (FMCG) market, it was less necessary to differentiate marketing and sales approaches substantially from those of competitors. Growing sustainably was not on the radar for many companies. Growth at scale was the primary focus.

This undifferentiated growth has slowed in recent years, however. Consumer packaged goods (CPG) companies were already navigating myriad changes in consumer behavior and channel structure—including the waning influence of traditional advertising, the rise of e-commerce, and increasingly mature consumers demanding higher-quality products. And then COVID-19 changed the landscape again. The pandemic has piled multiple pressures on China's consumer goods and retail industries, making the short- to mid-term promotion of leaner commercial operations critical. And looking ahead, sharper, more focused strategies to create sustainable, differentiated and profitable growth will be essential to cement a winning position in an increasingly complex and competitive environment.

As such, new thinking across key commercial levers such as pricing and assortment mix will be crucial. CPG companies will need to conduct deep, real-time data-based analysis to take a granular view of their commercial operations and identify smart growth opportunities. This is where revenue growth management (RGM) comes in.

RGM eschews traditional "gut feel" tactics to create value through granular analytics-driven approaches to pricing, promotions, assortment mix, trade investment and new product innovation. For CPG companies in many mature markets, it is increasingly recognized as a necessity to capture the next wave of growth. But in China, RGM is in its relative infancy.

What is RGM?

RGM starts with gaining deep insights into how and why shoppers in China purchase certain products, using these insights to highlight areas in which value can be captured. To achieve this, at-scale data analysis is deployed within key pockets of growth. Here, we explore some of those areas further.

— ***Pricing:*** Channel pricing can be adjusted based on product net price elasticities (for both the company and key competitors), historical growth, and the likely response from competitors. The potential impact of these adjustments is also measured. For example, McKinsey helped a leading beverage company realize that a 10 percent price increase of one of its core SKUs would lead to a negligible volume impact (different from what the company originally believed), and even less so if competition followed suit. Instead, overall share from a value perspective would actually increase, making this a worthwhile action to carry out

— ***Promotions:*** Advanced analytics, driven by two to three years of SKU and store-level data on baskets and traffic, can assess the effectiveness of promotions and discounts. We helped a large grocery retailer transform its promotions program. This is often done in collaboration with key CPG partners by identifying the SKUs to focus on, the different types of promotions to use (e.g. buy one, get one free versus a percentage discount), and how often to promote. This was done by analyzing more than 200,000 historical transactions. The result? A net sales uplift of 30 percent in pilot stores

— ***Assortment:*** Product portfolios for key channels can be optimized by identifying "hidden-gem" SKUs (which have low distribution and high sales velocity) and "long-tail" ones (characterized by low sales volume and low profit). A large snacks player, for example, identified the opportunity to rationalize its assortment portfolio of more than 1,000 SKUs by over 20 percent with minimal sales impact but with much healthier margins. Using point-of-sale data to analyze consumer purchase behavior across its portfolio, as well as that of its key competitors, the snacks player was able to migrate sales to more profitable and higher sales velocity SKUs, as well as unlock supply chain cost savings

— ***Trade investment:*** RGM can ensure a healthy ROI for trade investment in key channels and trade partners, by identifying how best to allocate trade spend. During COVID-19, when consumers turned to the internet in droves, L'Oreal China was one player that quickly increased trade investment in online channels (by around 40 percent), and boosted its online advertising and use of key opinion leaders. On top of this, it increased its O2O investment by about 150 percent. This involved expanding its O2O team and ramping up partnerships with O2O players that had a critical role during

the pandemic, such as Meituan and Ele.me. Partly due to this swift shift in channel investment, year-on-year L'Oreal China's first-half sales grew by 18 percent, and by 30 percent in the second quarter

— ***New product innovation:*** This involves doubling down on SKUs that meet evolving consumption habits and consumer behaviors, for example, the shift to at-home and "better for you" options during the increased time at home and focus on health engendered by COVID-19. Chando, a Chinese skin-care player, provides one illustration of this. It rapidly launched a line of 75%-alcohol hand sanitizer during the pandemic, taking just one month to move from the product ideation stage to launching the product online

As the above examples show, for companies that get RGM right, the rewards can be significant. A McKinsey survey of markets in which RGM is established shows that sales growth is 3.6 percentage points higher versus peer average. And the ROI of promotional events can rise by up to 15 percent.

The landscape for RGM in China

So how can CPG players in China develop the RGM capabilities that will help them traverse the challenges they face? There are three areas in which core changes need to be made. These are:

— ***Analytics:*** Internal and external data must be collected with discipline, and analyzed for macro-consumption trends, consumer segmentation, and behaviors by key channels. This will provide a holistic view of the operating environment to identify and provide in-depth detail on growth and cost-control opportunities. Data analytics are often required in three areas:

- Consumer behavior insights: Understanding key existing consumption occasions, identifying emerging ones, and determining how they differ by consumer segment and across regions, to help appropriately fulfil consumer needs
- Points of sale: Focusing on transaction data, such as volume, price and promotion at SKU level and by key channel (e.g., traditional trade, modern trade and e-commerce) enables the analysis of pricing trends, basket size and consumer stickiness
- Trade investment: Tracking expenditure and revenue at each key channel and with key channel partners (e.g., national customers and offline/offline distributors) gives a granular understanding of investment effectiveness across the value chain. In a rapidly evolving channel landscape, this establishes a more accurate view of ROI

All of this comes with certain challenges in China, which historically has lacked tailored data—especially in traditional trade channels. But there are a variety of approaches companies can use to “build” their own. These

include analyses of household consumption segmentation, store-map data, large-scale price surveys and more. Such data collection and analysis is crucial in China, given the country has diverging patterns of consumption behavior due to differences across city tiers, channels, regions and income levels. Arguably, this is getting ever easier in China with the help of more freely available and transparent retail data—including that from points of sale and loyalty cards—as well as demographic insights from mobile-service providers. Increasingly, in fact, the issue may be too much data—in these instances, defining specific RGM use cases and working backwards to be clear on which data sets to use can be extremely valuable

— ***Collaboration:*** Companies must remove departmental barriers and foster a highly collaborative culture, and everyone within the same organization should work towards targeted financial and strategic growth goals. RGM helps to align the overarching strategy and forge strong collaboration on all fronts, from data sharing and human capital to incentives and costs. In this way, CPG companies avoid the typical trap of over-indexing on growth in a specific area at the expense of overall growth (for example, online growing but offline declining when both channels could be growing simultaneously)

— ***Mindset:*** CPG companies in China have traditionally viewed growth in terms of market share and scale, and they have made commercial decisions on that basis. For example, a fear of losing market share has created a general resistance to price increases or SKU elimination, resulting in ineffective usage of shelf-space, stagnation of pricing and profit-margin growth, and an unfocused product portfolio strategy. RGM helps replace this mindset with an analytics-based, holistic growth approach—it is not share gain at all costs, but profitable and sustainable share gain that is important. This new mindset must permeate throughout the organization: from identifying opportunities to quantifying impact and executing strategy

The path to future growth

For CPG companies embarking on their RGM journey in China, there are some short- and longer-term measures to be considered.

Due to the pandemic, most companies have suffered heavy losses for at least one quarter of this year. The impact is notably most serious for product categories sold during the Spring Festival. With this in mind, we suggest consumer companies in China should start with short-term tactics to accelerate the implementation of RGM.

These tactics include establishing a cross-department RGM team to assess the financial impacts on the company; tweaking product mix to better reflect the current key demands of consumers, such as healthier products and basic daily necessities; and embracing channel structure changes, such as the shift to online.

Looking further ahead, there are a series of measures that should be implemented gradually to establish a more complete, precise, and large-scale RGM capability. These are:

— ***Introducing targeted pricing adjustments and promotional plans*** to further stimulate consumption

— ***Carrying out a greater number and variety of omnichannel promotions*** (online, O2O, social DTC). To keep pace with the rapid increase in online demand, data analysis and consumer management capabilities will also need to be improved

— ***Cooperating with retailers and distributors more effectively.*** At the same time, ROI must be accurately analyzed to improve the cost-effectiveness of joint investments

— ***Conducting a full evaluation and revamp of product portfolios*** as needed to ensure they meet changes in consumer preferences post-crisis over and above the short-term tweaks in product mix mentioned above

— ***Embedding RGM discipline into corporate DNA*** to ensure the effective implementation of an RGM mindset and strategy. For instance, this could include establishing an "RGM academy" to regularly train new talents on core RGM skillsets and methodology, and incorporating RGM-driven growth as a key agenda item during business planning

The COVID-19 pandemic has accelerated trends that were already emerging for China's CPG players. Growth in consumer goods and retail markets has slowed, consumers are becoming increasingly mature, business models have diversified, and competition has become increasingly fierce.

It's clear that for CPG companies in China, a transformation from scale-driven growth to more granular management of commercial operations has never been more urgent. High-quality, sustainable, and innovative growth is needed to move past the pandemic and lay solid foundations for future success. The time to act is now.

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The authors wish to thank Pauline Chen, Thomas Rüdiger Smith, and Hao Xu for their contributions to this article.

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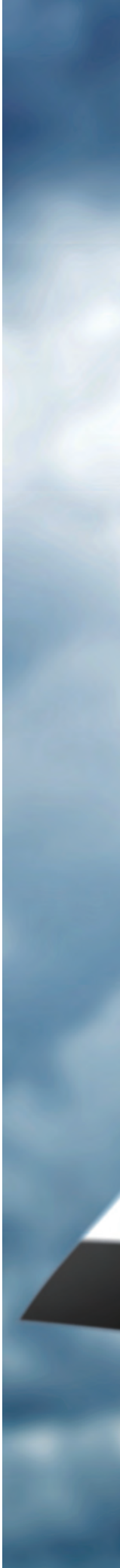

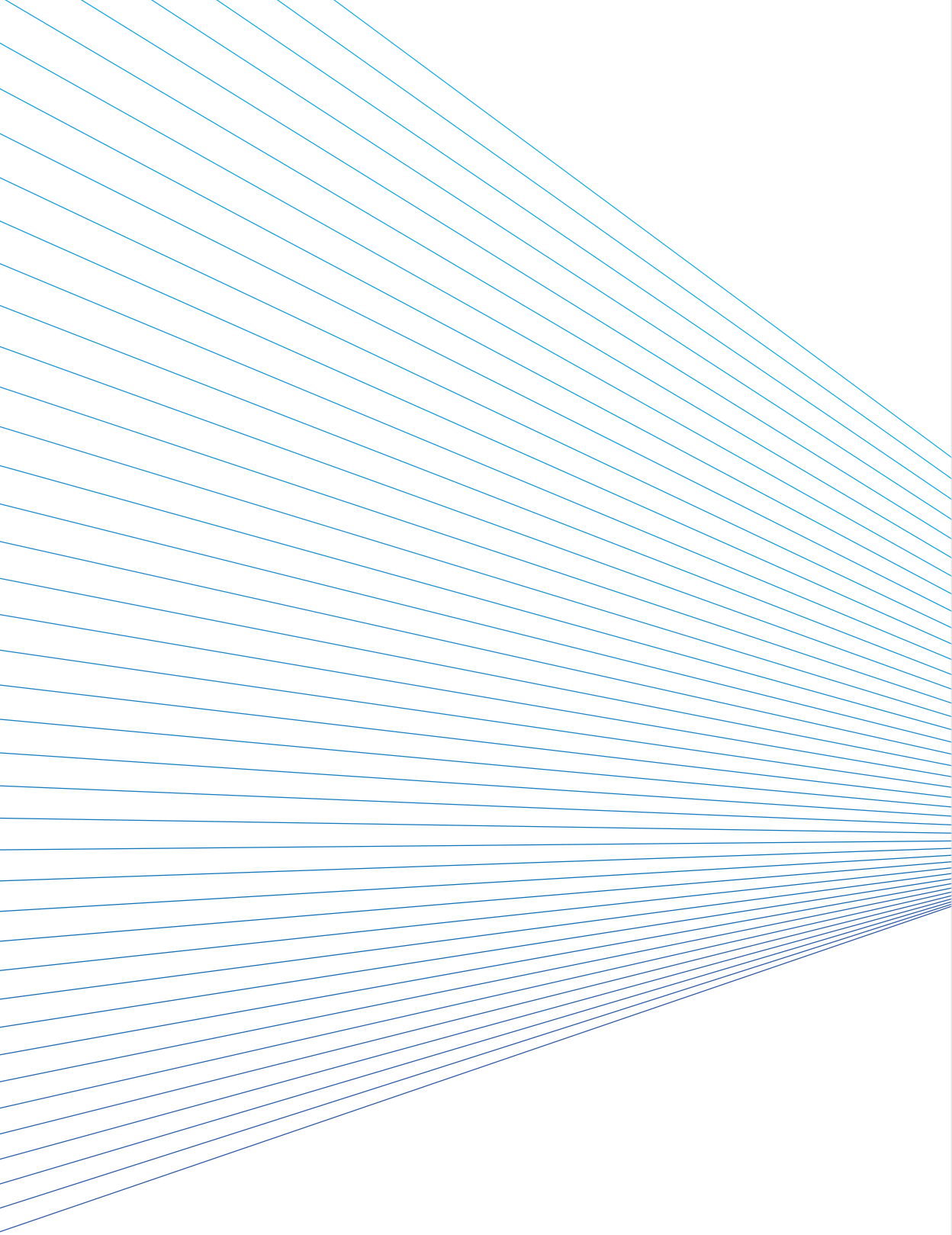

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November 2020
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